Exhibit 11

EXHIBIT 2 -- REVISED

SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM

415(b), (c), and (n) Compliance Strategy Report

Mary Beth Braitman
Terry A.M. Mumford
Katrina M. Clingerman
Ice Miller LLP
One American Square, Suite 3100
Indianapolis, IN 46282-0200

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TABLE OF CONTENTS

I.
INTRODUCTION

Ice Miller LLP ("Ice Miller") has been retained to provide a compliance review with regard to the Internal Revenue Code of 1986, as amended ("Code"), requirements applicable to the status of the San Diego City Employees' Retirement System ("SDCERS") as a qualified retirement plan under Code Section 401(a).

Ice Miller is not considering tax reporting and withholding under the Code nor any other federal law. We are also not deliberating any state law issues. Where state law must be considered, we are relying on interpretations provided by SDCERS counsel.

This report pertains to Code Section 415(b) and 415(c), and to Code Section 415(n) as it is related to 415(b) and 415(c). We have touched on Code Section 415(m) only with respect to the treatment of excess benefits under Code Section 415(b). We have prepared a separate briefing document for SDCERS on the topic of 415(m).

We have based this report on the material provided to us by SDCERS. We have not independently verified what has been provided to us. We are relying on SDCERS to provide us with documents, forms, and information necessary for this review.

This report was issued as part of the VCP supplement that was submitted to the IRS on August 9, 2006. In response to comments and questions by the IRS, this report has been revised. In addition, this report has been updated to reflect changes made by the Pension Protection Act of 2006 ("PPA").

II.
IMPORTANCE OF CODE SECTION 415 COMPLIANCE

A. SDCERS AS A QUALIFIED GOVERNMENTAL PLAN

Retaining "qualified plan" status under Code Section 401(a) is an important requirement for retirement plans. The primary advantages in retaining "qualified" status are that (i) employer contributions are not taxable to members as they are made (even when vested) and taxation only occurs when plan distributions are made, (ii) earnings and income are not taxed to the trust or the members; (iii) certain favorable tax treatments are available to members when they receive plan distributions, e.g., ability to rollover amounts; (iv) employers may "pick up" employee contributions; and (v) employer contributions to, and benefits from, the plan are never subject to employment taxes (i.e., FICA taxes). These advantages would generally not apply to a non-qualified plan.

B. CODE SECTION 415 LIMITS

One key qualification requirement applicable to qualified plans is the Code Section 415 limits. Code Section 415 benefit and contribution limits must be followed to protect the tax qualified status of a retirement plan under Code Section 401(a). These limits must be met by all plan members. If even one member is paid an annual benefit greater than Code Section 415

allows, or contributes more than Code Section 415 allows, theoretically, the entire plan will be disqualified.

C. PROPOSED REGULATIONS

On May 31, 2005, the IRS issued proposed regulations for Code Section 415 (the "Proposed Regulations"). The Proposed Regulations are mentioned below where their provisions are of particular interest or concern. However, given that it is expected that the IRS will finalize these regulations in 2006, and we anticipate some changes being made to the regulations as they move to final, we have not included an in-depth analysis of the Proposed Regulations in this overview. However, we have attached a summary of key areas addressed by the Proposed Regulations as Appendix A. Recently, the IRS issued Notice 2005-87, which states that the grandfather provisions contained in the Proposed Regulations will be expanded upon issuance of final regulations.

III.
OVERVIEW OF LAW WITH RESPECT TO DEFINED BENEFIT LIMITATIONS

This Section of our Compliance Strategy Report provides an overview of the federal law with regard to Code Section 415(b). The impact of Code Section 415(b) on SDCERS and our specific recommendations for a compliance strategy are included in the next Section of this Report.

A. BASIC BENEFIT LIMITS

1. Current Limits

As amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the basic requirement of Code Section 415(b) is that the annual benefit in the form of a single life annuity provided to a member who is between the ages of 62 and 65 may not exceed the lesser of: (1) $160,000 as adjusted for inflation in $5,000 increments (the "Dollar Limit"), or (2) 100% of average compensation (the "Salary Limit"). Code Section 415(b)(1). The Salary Limit does not apply to governmental plans such as SDCERS. Therefore, the following discussion and our methodology do not include the Salary Limit.

The Proposed Regulations would require that limits be applied on an annual basis to the accrued benefit. In Ice Miller's comment letter to the IRS with regard to the Proposed Regulations, we stated the following on this point:

> We do have one overarching concern with the Proposed Regulations. They are fundamentally based on an annual accrual concept. For private sector plans this works well and is entirely consistent with the requirements and structure of Code Sections 411 and 412. However, these rules are not applicable to governmental plans, and, for most governmental plans, this concept does not work. In the governmental environment, vesting is generally determined by state law or local ordinances. In many cases, there is no "accrual" concept in the governing laws, but rather set benefits payable at certain events.

Therefore, we have prepared this compliance strategy report on the assumption that benefit testing for 415(b) purposes will be done at benefit payout.

2. Limitation Year

The annual benefit is tested in a "limitation year." Unless an election is made by the employer, the limitation year is the calendar year. Treas. Reg. § 1.415-2(b)(1). An employer that maintains more than one qualified plan may elect to use different limitation years for each such plan. Treas. Reg. § 1.415-2(b)(3).

Retrospectively, the IRS is requiring that SDCERS use a July 1 fiscal year for testing. The analysis of 415(b) limits in the context of the Fiscal Year is summarized in the following regulatory provision:[1]

> The adjusted dollar limitation applicable to defined benefit plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Benefit payments and accrued benefits for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1.

Prop. Treas. Reg. § 1.415(d)-1(b)(3) (emphasis added). Applying this regulation to the SDCERS situation, we come up with the following example:

> As of July 1, 2005, the limitation on the annual benefit is $170,000, but assume that the member's annual benefit for the Fiscal Year would be $175,000 under the applicable formula. (For purposes of this example we are assuming a single straight life annuity with no after-tax contributions and no rollovers to consider.) The monthly benefit that is paid from July 1, 2005, through December 31, 2005 cannot exceed 1/12 of $170,000. However, starting January 1, 2006, when the annual limit goes to $175,000 the monthly benefit can increase so it is 1/12 of $175,000 plus the amount ($30,000) needed to "make-up" for the amount that was not paid in 2005 because of the applicable limit. Under this approach, no excess would be paid out of an excess benefit plan in 2005 and the make-up payment would be paid in 2006.

Prospectively, as of January 1, 2007, SDCERS will move to a calendar year for 415 testing.

B. TAMRA Election

Section 415(b)(10) of the Code was added by the Technical and Miscellaneous Revenue Act of 1988 (sometimes called TAMRA) to offer state and local government plans a means of complying with the Section 415 limits without violating state anti-cutback laws. Under this Section, the defined benefit limit for an employee who became a participant in the plan before January 1, 1990, would not be less than his or her accrued benefit determined without regard to any plan amendment adopted after October 14, 1987. However, for a state or local government

[1] We have used the Proposed 415 regulation because we think the explanation is clearer than current regulations.

to take advantage of Section 415(b)(10), each employer maintaining the plan was required to elect, before the close of the plan year beginning in 1990, to apply the defined benefit limits applicable to private plans to employees who first became participants after 1990. However, there were also special provisions for state-wide statutory changes. For plans that made a TAMRA election, the qualified participants would still have their TAMRA protection. Revocation of a TAMRA election is permitted pursuant to Code Section 415(b)(10)(C)(ii), effective for all plan years to which the election applied and to all subsequent plan years, provided the revocation is accomplished by the last day of the third plan year beginning after August 20, 1996.

C. AMOUNTS EXCLUDED FROM TESTING

For purposes of Code Section 415(b), the annual benefit means the benefit payable annually in the form of a straight life annuity (with no ancillary benefits), without considering payments made from a qualified excess benefit arrangement, after-tax employee contributions, and any rollover contributions. Code Section 415(b)(2).

1. Ancillary Benefits

"Ancillary benefits" do not count toward the benefits subject to Code Section 415. As a result, any benefit that is an ancillary benefit can exceed the 415 limits without the plan being disqualified. Generally, "ancillary benefits" are benefits not directly related to retirement income benefits. Ancillary benefits include "pre-retirement disability benefits and death benefits (such as in-service death benefits)." Code Section 415(b)(2)(B); Treas. Reg. § 1.415-3(c)(ii).

a. Pre-Retirement Disability Benefits

According to a non-precedential IRS Information Letter (IRS Information Letter on § 415 Limitations on Public Plans dated August 20, 1991 ("IRS Letter")) discussing Code Section 415 limitations on governmental plans, pre-retirement disability benefits under governmental plans are not taken into account under Code Section 415, even if the pre-retirement disability benefits exceed the "qualified disability benefit" limitations established in Code Section 411(a)(9). IRS Letter, § 1 Q&A-3; Treas. Reg. § 1.415-3(c)(ii). However, pre-retirement disability benefits are required to comply with Revenue Ruling 72-3, which prohibits a pension plan benefit from exceeding 100% of the employee's compensation. For this purpose, the definition of the term "compensation" is similar to the definition identified in Code Section 415 and is subject to cost of living increases. Thus, there is still a test that needs to apply to pre-retirement disability benefits. Contrasted to pre-retirement disability benefits, post-retirement disability benefits must be taken into account for purposes of complying with the Code Section 415 limitations. IRS Letter, § 1 Q&A-4. Thus, (1) post-retirement disability benefits, (2) line of duty disability benefits paid post normal retirement date, and (3) pre-retirement disability benefits payable post normal retirement age will be tested under Code Section 415(b).

b. Pre-Retirement Death Benefits

Pre-retirement death benefits provided under a governmental plan are also exempt from the Code Section 415 limits. IRS Letter, § 1 Q&A-5; Treas. Reg. § 1.415-3(c)(ii). However, pre-retirement death benefits must meet the incidental benefit requirements of Code Section 401

and the regulations thereto. Generally speaking, death benefits are incidental where the plan provides a pre-retirement death benefit that is no greater than 100 times the monthly annuity benefit provided under the plan, or the cost of the death benefit does not exceed 25% of the total cost of all benefits for that participant. (This latter test would be one that would be analyzed by an actuary.) Revenue Ruling 74-307, 1974-2 C.B. 126.

2. Qualified Excess Benefit Arrangement ("QEBA")

Effective for years after December 31, 1994, state and local government employers may maintain "qualified governmental excess benefit plans" ("QEBA") under Code Section 415(m). Excess Plans are plans that provide benefits that cannot be provided under a qualified plan due to the limits on contributions and benefits. Excess Plans permit state and local government employers to provide benefits to their employees:

(1) without jeopardizing plan qualification because of the limits on contributions and benefits under Code Section 415,

(2) without jeopardizing a plan's status under Code Section 457 as an "eligible deferred compensation plan," and

(3) without the income that accrues to the qualified governmental excess benefit plan being taxable to the plan's government sponsor.

As we have discussed, we will not be addressing Code Section 415(m) and QEBAs in detail in this report, but in a separate report. However, for the purposes of determining retrospective benefit testing protocols, we think that it is relevant to consider the following provisions that accompanied the enactment of Code Section 415(m):

> Nothing in the amendments made by this section shall be construed to imply that a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) fails to satisfy the requirements of section 415 of such Code for any taxable year beginning before January 1, 1995.

P.L. 104-188, § 1444(c)(2). Under this grandfather section, retroactive testing for plan qualification purposes does not need to consider payments made prior to January 1, 1995.

3. Allocation of Benefits to After-Tax Employee Contributions

Contributions made on an after-tax basis to a defined benefit plan are deemed to be annual additions and subject to Code Section 415(c) limits (discussed below in more detail). Therefore, because the benefits have already been tested under Code Section 415(c), any portion of a defined benefit attributable to those after-tax contributions may be subtracted from the annual benefit before it is tested under Code Section 415(b). However, it is important to note that benefits that would be attributable to excess 415(c) contributions would not be "subtracted" from the annual benefit for 415(b) testing purposes.

a. Mandatory Employee Contributions

Treas. Reg. Section 1.415-3(d)(1) provides that the annual benefit attributable to mandatory contributions is determined by using the factors described in Code Section 411(c)(2)(B) "regardless of whether Section 411 applies to that plan." Regulations under Treas. Reg. Section 1.411(c)-1(c) establish the required method for allocating a portion of the defined benefit to the after-tax employee contributions for purposes of excluding this amount from the final annual benefit to be tested. The method requires calculation of the after-tax (not picked up) employee contributions (both mandatory employee contributions and any voluntary after-tax payments for service purchases unless tested under Code Section 415(n)), plus interest, at rates specified by the regulations. See Treas. Reg. § 1.411(c)-1(c). Generally, interest is computed at the rate provided by the plan until the last plan year before Code Section 411(a)(2) does not apply. Id. Thereafter, a plan should use a 5% interest rate factor.

Because governmental plans are exempt from Code Section 411, it is not clear how to apply this guidance to a governmental plan to which Section 411(a)(2) never applies. The Proposed Regulations provide that Code Section 411 should apply to this calculation even if the section is not applicable to the plan. Ice Miller commented on this point as follows:

> Because governmental plans are always exempt from Code Section 411, it is not clear how to apply this guidance to a governmental plan to which Section 411(a)(2) never applies. We have not located any IRS guidance on point. A literal reading suggests that, since Code Section 411(a)(2) never will apply to a governmental plan, actual plan assumptions should continue to be applied. We think that this reading is the best approach in the governmental plan context.

b. Voluntary After-Tax Contributions

The rules governing mandatory employee after-tax contributions are also applicable to voluntary after-tax contributions. Treas. Reg. § 1.415-3(d)(3). However, a special category of voluntary after-tax employee contributions – for permissive service credit purchases – is discussed below.

4. Employee After-Tax Contributions for Permissive Service Credit

Code Section 415(n) establishes a limitation structure for "permissive service credit" purchases, instead of relying on the existing Code Section 415(c) defined contribution limitations. This subsection allows Code Section 415 to be satisfied by a purchase of permissive service credit if either a modified 415(b) limit is met or a modified 415(c) limit is met. These limits can be applied on a participant-by-participant basis rather than choosing to apply the limit on a plan-wide basis. For example, some participants could satisfy the modified defined benefit limit when making a purchase of permissive service credit, while others could satisfy the modified defined contribution limit.

a. Modified 415(b) Limit

For purposes of Code Section 415(n), the defined benefit limit in Code Section 415(b) may be met by treating the accrued benefit derived from all permissive service credit as part of

the member's annual benefit. Code Section 415(n)(2)(A) provides that, where the dollar limit under 415(b) is reduced for retirement before age 62, "the plan shall not fail to meet the reduced dollar limit under Subsection (b)(2)(C) [the age-reduced dollar limit] solely by reason of this subsection." Thus, the plan will not fail to meet the age-reduced dollar limit solely because the accrued benefit derived from the permissive service credit purchase is included in the 415(b) test.

b. Modified 415(c) Limit

For purposes of Code Section, only the dollar limit under Code Section 415(c) applies ($40,000 (adjusted for inflation) by treating all permissive service contributions as an annual addition under that limit.

c. Definition of Permissive Service Credit

The special testing rules apply only if the service being purchased qualifies as permissive service credit. Code Section 415(n)(3) defines "permissive service credit" as follows:

> (3) PERMISSIVE SERVICE CREDIT.–For purposes of this subsection–
>
> (A) IN GENERAL.–The term "permissive service credit" means service credit–
>
> (i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,
>
> (ii) which such participant has not received under such governmental plan, and
>
> (iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.
>
> Such term may include service credit for periods for which there is no performance of service, and, notwithstanding clause (ii), may include service credited in order to provide an increased benefit for service credit which a participant is receiving under the plan.

Code Section 415(n)(3)(A). The proper interpretation of the Code Section 415(n) definition of permissive service credit is not a settled term. The Proposed Regulations do not address 415(n) issues. However, the PPA did clarify that benefit enhancement purchases (buying a higher multiplier on service a member already has in a plan) or airtime purchases (buying service credit for a period for which there is no performance of service) both qualify as permissive service credit.

d. Nonqualified and Qualified Permissive Service

Permissive service credit can be categorized into two types. First, the Code defines "non-qualified service credit" as all permissive service credit that does not fall within one of the itemized types listed in Code Section 415(n)(3)(C). Although the Code does not use this term, we have termed the types of service included in this list as "qualified permissive service."

Code Section 415(n)(3)(C) defines "nonqualified service" as all permissive service except for the following types of service (which we have designated "qualified permissive service"):

- Service (including parental, medical, sabbatical, and similar leave) for the US government, any state or political subdivision thereof, or any agency or instrumentality of any of the foregoing.

- Service (including parental, medical, sabbatical, and similar leave) for an educational organization which is a public, private, or sectarian school which provides elementary or secondary education (through grade 12) as determined under state laws.

- Service for an association of employees of the U.S., state or political subdivision thereof, or an agency or instrumentality of the foregoing.

- Military service (non-USERRA covered) recognized by the governmental plan.

However, service under the first three (3) points above will be nonqualified service if recognition of the service would cause the member to receive a retirement benefit for the same service under more than one plan. Code Section 415(n) does not permit a plan to take more than five (5) years of nonqualified service into account, or to give members credit for any nonqualified service before the member has at least five (5) years of participation in the plan. Code Section 415(n)(3)(B). The PPA clarified that these limits do not apply to trustee-to-trustee transfers from a 457(b) plan or a 403(b) plan for the purchase of permissive service credit.

It is important to note that "nonqualified service" is still one type of permissive service that is described in Section 415(n)(3)(A). Therefore, nonqualified service is available for purchase and may be tested under Code Section 415(n) special testing provisions.

e. Effective Dates

The service purchase testing provisions for permissive service credit under Code Section 415(n) are subject to a transition rule. The transition rule provides that the defined contribution limits of Code Section 415(c) will not be used to reduce the amount of permissive service credit an "eligible participant" can purchase below what they were allowed to purchase under the terms of the plan as in effect on the enactment date, August 5, 1997. An "eligible participant" is an individual who first becomes a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of enactment) of the governing body with authority to amend the plan ends.

Because the term "permissive service" is used in the grandfather provision, we believe that the IRS would apply a consistent definition of permissive service credit to the transition rule. As a result, the transition provision could permit greater purchases of nonqualified service and could permit permissive service purchases that exceed 415(c) and (b) limits, but would not extend to the purchase of service that did not meet the definition of permissive service credit.

5. Picked-Up Contributions

It is important to note that pre-tax contributions ("picked-up contributions"), whether mandatory or voluntary, are not treated as post-tax contributions. The benefit attributable to picked-up contributions is subject to 415(b) testing.

a. Code Section 414(h)

For governmental plans, "where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions." Code Section 414(h)(2). Consequently, if a governmental employer correctly picks up employee contributions, such contributions will no longer be included in the employee's gross income, nor will they be subject to income tax withholdings. Treas. Reg. § 1.402(a)-1; Rev. Rul. 77-462, 1977-2 C.B. 358. However, such contributions may be treated as employee contributions for all other purposes, including calculating benefits, state taxes, cost of living increases, salary increases, and bonuses. GCM 39540; PLR 8630073.[2] In addition, certain pick-up contributions are taken into account as "wages" for FICA purposes. Code Section 3121(v)(1)(B). The only way to obtain confirmation that the IRS approves of a pick-up is through a private letter ruling.

Revenue Ruling 2006-43 has established the following requirements for an effective pick-up:

- The employer must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee:
  - The employer must take formal action to so provide.
  - The action must be taken by a person duly authorized to act with respect to the employer.
  - The action may only apply prospectively and must be evidenced by a contemporaneous written document; and
- The employer may not permit the employee to have a cash or deferred election right (as defined in Treasury Regulation § 1.401(k)-1(a)(3)) with respect to the designated contributions from the date of the pick-up forward:
  - That is, the employee may not opt out of the pick-up;

[2] It is important to note that private letter rulings do not have precedential value for other taxpayers.

- The employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan; and

- The pick up is not effective prior to the last action required to be taken by the employer and/or the employee.

See also Rev. Rul. 81-35; Rev. Rul. 81-36; and Rev. Rul. 87-10.

b. Pick-ups of Service Purchases under Governmental Plans

The IRS has approved the use of pick-ups for contributions to purchase service credit under governmental plans that have sought private letter rulings. In order to meet the requirements for an effective pick-up of an employee's service purchase, the above requirements for a pick-up must be met plus the following:

- The employee must elect to have the contributions for the service purchase made pursuant to a binding and irrevocable payroll reduction authorization.

- The payroll authorization specifies the amount by which the employee's compensation will be reduced in order to purchase the service credit and the duration of the authorization.

- The authorization cannot be revoked, except in limited circumstances involving termination of employment or death of the employee.

The most recent IRS rulings on service purchase pick-ups have included the following limitation language:

> This ruling is based on the conditions that (1) a participant who elects to purchase a particular type of service credit may not make more than one irrevocable election to purchase that type of service credit; and (2) a participant may make more than one irrevocable election to purchase service credit provided any subsequent election is for the purchase of a different type of service credit, is irrevocable, and does not alter or amend the terms and conditions of any prior election to purchase service credit.

PLR 200410025 (March 3, 2004); PLR 200347020 (November 7, 2003).

6. Amounts Attributable to Rollovers

Rollovers to a defined benefit plan are treated similarly to employee contributions for purposes of 415(b) testing:

> If the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if the employees contribute to the plan or make rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16), the determinations as to whether the limitation described in paragraph

(1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A).

Code Section 415(b)(2(B). This provision was amended by EGTRRA and is not reflected in the current rules. However, the Proposed Regulations treat rollovers in a manner similar to after-tax contributions, so that the benefit attributable to the rollover must be converted in accordance with prescribed factors.

7. Amounts Attributable to Transfers between Qualified Plans

Under the current regulations, amounts attributable to a transfer from a qualified plan (a plan under Code Section 401(a)) are not clearly addressed for 415 testing purposes, especially where a transfer is made from a defined contribution plan to a defined benefit plan. Treas. Reg. § 1.415-2(b). But see PLR 200347020 (Favorable ruling to make transfers from state defined contribution plan to defined benefit plan to purchase service); PLR 200345042 (Favorable ruling to make transfers from state defined contribution plan to defined benefit plan to purchase service); PLR 200335035 (Favorable ruling to make elective transfer from grandfathered 401(k) to defined benefit plan of amount necessary to buy service credit; transferred amounts held separately).

However, under the Proposed Regulations, transfers between defined benefit plans that must be aggregated are included for 415(b) testing purposes. Prop. Treas. Reg. § 1.415(b)-1(b)(3)(i)(A). But see PLR 200411046 (Favorable ruling approving elections to participate in defined contribution, defined benefit or hybrid plan with plan-to-plan transfers available at member's option on initial election; transfer available on subsequent elections to buy service credit with certain transferred amounts.)

8. Plan-to-Plan Transfers from a 457(b) or 403(b) Plan

There is an open question as to whether transfers made from 457(b) and 403(b) plans could also be excluded. Currently, federal regulations limit this exclusion to transfers from qualified plans. However, Code Sections 403(b)(13) and 457(e)(17) permit a direct trustee-to-trustee transfer of amounts from a 403(b) annuity or a 457 deferred compensation plan to a governmental defined benefit plan to purchase permissive service credit (either qualified or non-qualified) as defined in Code Section 415(n)(3)(A) and to repay contributions and earnings with respect to a previous forfeiture of service credit as defined in Code Section 415(k)(3). The final Treasury Regulations for 457 plans make it clear that the IRS believes that the term "permissive service credit" for purposes of Code Section 457(e)(17) must be defined consistently with Code Section 415(n), although the limiting provisions of 415(n) do not have to be applied. In addition, the preamble to the Final Regulations raises another issue:

> . . . Treasury and the IRS have concluded that section 415(n) does not apply to such a transfer in any case in which the actuarial value of the benefit increase that results from the transfer does not exceed the amount transferred.

68 F.R. 41232.

The passage of the PPA may have resolved many issues regarding transfers from 457(b) and 403(b) plans because the PPA clarifies that there is no limitation on the amount of service that can be purchased with the transfer and that the transfers can be made for a very broad category of service purchases. When that is coupled with the preamble to the 457 Final Regulations, it seems that the 415(n) limitations (415(c) or 415(b)) do not apply where the actuarial value of the benefits does not exceed the value of the transfer.

9. Restoration of Contributions

Code Section 415(k)(3) provides that any repayment of contributions (including interest) will not be taken into account for Code Section 415 purposes if the repayment is to a governmental plan with respect to an amount previously refunded on a forfeiture of service credit under that plan or any other governmental plan maintained by the state or any local governmental employer within the same state. Thus, so long as the amount repaid does not exceed the amount refunded, plus interest, Code Section 415 should not apply. However, it is important to note that the Proposed Regulations do not agree with this interpretation, but rather treat the benefit attributable to the repayment as includible for 415(b) testing purposes. Prop. Treas. Reg. § 1.415(b)-1(b)(2)(ii).

D. AGE-BASED ADJUSTMENT TO LIMITS

1. Benefits Before Age 62

When the benefit begins before the participant reaches age 62, the Dollar Limit benefit limit generally must be actuarially adjusted so that the limit (as reduced) equals an annual benefit that is payable when the retirement benefit begins, and which is the equivalent of the Dollar Limit beginning at age 62. Code Section 415(b)(2)(C). The actuarial adjustments must be made in accordance with Code Section 415(b)(2)(E). Pre-EGTRRA, Code Section 415(b)(2)(F) limited the actuarial reduction for governmental plans to a $75,000 benefit payable at age 55 or, if the benefit began before age 55, the actuarial equivalent of a $75,000 benefit beginning at age 55.

a. Exception for Public Safety and Military

However, no age-based actuarial reduction is required for benefits beginning prior to age 62 for qualified participants. A qualified participant is defined as a participant:

> (i) in a defined benefit plan which is maintained by a State or political subdivision thereof,
>
> (ii) with respect to whom the period of service taken into account in determining the amount of the benefit under such defined benefit plan includes at least 15 years of service of the participant –
>
> > (I) as a full-time employee of any police department or fire department which is organized and operated by the State or political subdivision maintaining such defined benefit plan to provide police protection,

> firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision, or
>
> (II) as a member of the Armed Forces of the United States.

Code Section 415(b)(2)(G)-(H). The interpretation of this provision has caused some concern among public pension plans. For example, it was not entirely clear whether the qualified participant had to be a sworn officer of a police department or whether any employee of a police department would be covered by this provision. The Proposed Regulations offer some increased flexibility for a "qualified participant," which is defined as:

> a participant in a defined benefit plan that is maintained by a state or local government with respect to whom the service taken into account in determining the amount of the benefit under the defined benefit plan includes at least 15 years of service of the participant ...[a]s a full-time employee of any police department or fire department that is organized and operated by the state or political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such state or political subdivision.

Preamble to the Proposed Regulations. The proposed regulations would clarify that the application of this rule depends on whether the employer is a police department or fire department of the state or political subdivision, rather than on the job classification of the individual participant.

This exception is very beneficial to public safety officers and to other employees of police and fire departments, including non-public safety personnel. However, this definition does not cover employees who exercise police powers on behalf of a public agency but who are not employed by an agency that is called a "police department" (such as a Public Safety Department or Emergency Services Authority). An additional difficult situation arises with regard to emergency services personnel who are employed by an agency that is not called a "fire department" or "police department" but who are performing emergency medical services within the local government's jurisdiction. It remains to be seen whether the IRS will provide for further flexibility.

b. Exception for Disability and Death Benefits

In addition, the actuarial reduction for benefits beginning before age 62 does not apply to disability benefits or survivor benefits payable in the event of the death of the member provided under a governmental plan. Code Section 415(b)(2)(I).

c. Exception for Permissive Service Credit Procedures

A purchase of permissive service credit may be tested under Code Section 415(b) without regard to the reduction for early retirement.

2. Benefits After Age 65

For all members, if the retirement benefit under the plan begins after age 65, the Dollar Limit is increased so that it is the actuarial equivalent to an annual benefit beginning at age 65. Code Section 415(b)(2)(D). The actuarial assumptions used to make this conversion are set forth in Code Section 415(b)(2)(E).

E. ADDITIONAL SPECIAL RULES

1. Small Benefits

Code Section 415(b) has a number of additional special rules that may impact governmental employers. Code Section 415(b)(4) provides that defined benefit limits will not be applied to reduce a participant's benefits when total annual benefits are $10,000 or less. However, this limitation only applies "if the employer has not at any time maintained a defined contribution plan in which the employee has participated." Code Section 415(b)(4)(B).

2. Less than 10 Years of Participation

When an employee has less than ten years of participation in a defined benefit plan, the basic Code Section 415(b) Dollar Limit (or the minimum $10,000 exemption from testing) is reduced by 10% for each year less than ten in which the employee participated in the defined benefit plan for other than death and disability benefits (but not below 1/10th of the Dollar Limit). Code Section 415(b)(5) and Treas. Reg. § 1.415-3(g).

F. OPTIONAL FORMS OF BENEFITS

Benefits in a form other than a straight life annuity must be actuarially adjusted to a straight life annuity beginning at the same age in accordance with the otherwise applicable rules. For example, annuity benefit forms including a post-retirement death benefit or an annuity providing for a guaranteed number of payments must be adjusted for purpose of applying the Code Section 415(b) limit. See Treas. Reg. § 1.415-3(c)(1)(ii). No adjustment is required for certain benefits, including the actuarial value of a qualified joint and survivor annuity ("QJSA") that is fully or partially subsidized, the value of benefits not directly related to retirement benefits, and certain cost of living increases. See Treas. Reg. § 1.415-3(c)(2).

Code Section 415(b)(2)(E)(i) provides that "for purposes of adjusting any limit under subparagraph (C) [adjustment to dollar limit before age 62] and ... for purposes of adjusting any benefit under subparagraph (B) [adjustment for other forms of benefits], the interest rate assumption shall not be less than the greater of 5% or the rate specified in the plan."[3] With respect to adjusting a different form of benefit (under Code Section 415(b)(2)(B)), different interest rate assumptions are used in the case of a form of benefit subject to Code Section 417(e)(3). Code Section 415(b)(2)(E)(ii). However, because SDCERS is a governmental plan which is not subject to Code Section 417(e)(3), these different interest rate assumptions would not be applicable. Rev. Rul. 98-1, Q&A-3 (plans that are not subject to Code Section 417(e)(3),

[3] Code Section 415(b)(2)(E)(iii) also provides that these same interest rate assumptions should be used in adjusting the 415(b) limit when benefits begin after age 65, except that the rate may not be greater than the lesser of the two rates.

such as governmental plans, are not subject to the interest rate requirement under Section 415(b)(2)(E)(ii)).

Thus, for purposes of converting a form of benefit to a straight life annuity, the interest rate assumption should not be less than the greater of 5% or the rate specified in the plan (i.e., the rate used under the plan for actuarial equivalence for that specific benefit form). See IRS Announcement 95-99.

G. COST-OF-LIVING ADJUSTMENT OF CODE SECTION 415(b) LIMITS

Cost of living adjustments to a member's benefits are permitted under Code Section 415(d) and Treas. Reg. § 1.415-5(a)(3). By regulation, the adjusted dollar limitation "is applicable to . . . employees who have retired or otherwise terminated their service under the plan with a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive such benefits, as long as the plan specifically provides for the adjustment." Treas. Reg. § 1.415-5(a)(3).

With regard to the COLA on SDCERS benefits, the current regulations provide that no adjustment to the benefit's value is necessary for post-retirement cost of living increases "to the extent that such increases are in accordance with" Code Section 415(d) and Treas. Reg. § 1.415-5. Treas. Reg. § 1.415-3(c)(2)(iii). The correct interpretation of this phrase is a matter of some debate. However, for purposes of the 415 VCP filing, SDCERS has agreed that for retrospective testing, all fixed COLAs will be considered as part of the annual benefit for 415 testing purposes, in accordance with Cheiron testing protocols. See Exhibit A. Prospectively, SDCERS is proposing that benefits be allowed to increase as 415(b) limits increase. See Exhibit B; see SDMC §24.1004 (*amendment pending*).

H. CONSIDERATION OF AN ALTERNATE PAYEE'S BENEFITS FOR TESTING PURPOSES

Benefits payable to an alternate payee under a qualified domestic relations order are treated as part of the member's benefit for purposes of applying the benefit limits under Code Section 415. IRS Notice 87-21, Q&A-20; see also Announcement 95-99, Q&A-17.

I. TESTING OF THE SURVIVOR PORTION OF A BENEFIT

The rules which apply to a member's benefit also apply to a survivor's benefit. Under Code Section 415(b)(1), the annual benefit may not exceed the applicable dollar limit ($170,000 for 2005). The Code defines "annual benefit" as "a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions ... are made." Code Section 415(b)(2)(A) (emphasis added). If a benefit under the plan is payable in any form other than this form,

> the determinations as to whether the [415(b)] limitation ... has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by adjusting such benefit so that it is the equivalent to the benefit described in subparagraph (A). For purposes of this subparagraph, any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a

qualified joint and survivor annuity (as defined in section 417) shall not be taken into account.

Code Section 415(b)(2)(B).

Thus, the benefit that is subject to testing is a straight life annuity, and any other benefit under a plan which is payable in a form other than a straight life annuity (other than a qualified joint and survivor annuity) must be converted to a straight life annuity in order to pass 415(b) testing. In essence, even if a benefit actually being paid is not a straight life annuity, it still should have been converted to a straight life annuity and tested under Code Section 415(b). Thus, upon the death of the retiree, there would be no need for a "conversion" of the survivor's benefit or a change to the existing 415(b) limit as applied to the retiree's benefit. Rather, upon the death of a retiree, the survivor's benefit continues to be tested against the retiree's benefit limit. (This would also be true of a qualified joint and survivor annuity, even though it is not converted to a straight life annuity for testing purposes, because such benefit is exempted from the conversion requirement.)

J. AGGREGATION OF TOTAL SDCERS BENEFITS FOR TESTING PURPOSES

Under a multiple employer plan, two (2) or more employers that are not part of a related group participate in the same plan. In applying the Code Section 415 limits to such multiple employer plans, Treas. Reg. § 1.415-1(e)(1) provides that for a participant in a multiple employer plan, benefits or contributions under the plan attributable to such participant from all of the employers maintaining the plan and compensation from all the participating employers must be taken into account. Generally, if the employers had maintained separate plans this rule would not apply, and the Code Section 415 limits would be separately determined for each employer because they are not part of a related group.

IV.
APPLICATION OF CODE SECTION 415(b) TO SDCERS AND RECOMMENDATIONS

The purpose of this Section of this Compliance Strategy Report is to relate the requirements of Code Section 415(b) as outlined in the previous Section to SDCERS.

A. PLAN DOCUMENT PROVISIONS

SDMC § 24.1004(h) (*per pending amendment*) provides that employee contributions to, and benefits from, SDCERS must comply with the Code Section 415 limitations on contributions and benefits. The provision further confirms the fiscal year as the testing year retrospectively, and the calendar year as the limitation year beginning on January 1, 2007. SDMC § 24.1004(h) permits SDCERS to modify contributions as necessary to ensure compliance with Code Section 415.

B. OPERATIONAL COMPLIANCE

1. Definition of the Annual Benefit for 415(b) Testing

Under Code Section 415(b), the benefit that is subject to testing is the benefit payable annually in the form of a straight life annuity ("SLA") with no ancillary benefits to which employees do not contribute and no rollover contributions are made. Code Section 415(b)(2)(A).

a. Straight Life Annuity

The benefit that will be tested is the SLA plus the value of the DROP benefit (if applicable) on a straight life basis.

For purposes of calculating the SLA, the value of any subsidy provided as part of a qualified joint and survivor annuity was included only when the beneficiary was other than a qualified spouse. We understand that using the SDCERS "maximum benefit" would generally accomplish this purpose.

b. Post-Retirement Increases

SDCERS members receive two post-retirement adjustments: a fixed COLA and a 13th Check. Certain groups receive additional adjustments: a Supplemental COLA and benefit increases under the Corbett settlement. The protocols in Exhibit A treat the fixed COLA as part of the annual benefit for retrospective testing purposes. The protocols in Exhibit B allow benefits to increase as 415(b) limits increase. With respect to the Supplemental COLA, 13th Check and Corbett Settlement, these benefits will also be treated as part of the annual benefit for both prospective and retrospective testing. However, the value of the post-retirement $2000 death benefit is not included for 415(b) testing. Treas. Reg. § 1.415-3(a)(2)(i)(B).

- **Fixed COLA**

As indicated in Exhibit A, retrospectively, the Fixed COLA will be considered in defining the testing group. From there, all members of the testing group will be annually tested to determine if they exceed the applicable annual 415(b) limit. Prospectively, the Fixed COLA will be taken into account in establishing the annual benefit.

- **13th Check**

In our various meetings, the question has arisen how to treat the 13th Check for testing purposes because under the Municipal Code the 13th Check is treated as a contingent benefit. In order to respond to the question, we considered the history of the 13th Check. From 1/1/95 to now, in all but two years the 13th check was paid in full. In 2003 no 13th Check was paid and in another year over 99% of the 13th Check was paid. Based upon this history, it was decided that for 415(b) testing purposes, the 13th Check will be treated as an additional annual benefit. (Note: This is consistent with the treatment described in the Rollover Compliance Report and VCP Filing.)

- **Supplemental COLA**

For 415(b) testing purposes, the supplemental COLA is already treated as part of the annual benefit. This benefit is referred to in the testing chart as the "Star COLA."

- **Corbett Settlement Amounts**

For purposes of 415(b) testing, the Corbett settlement amount will be treated as part of the annual benefit.

The Corbett-covered group is a closed group.

- **Andrecht Settlement Amounts**

The Andrecht Settlement amounts were included in the calculation of the annual benefit provided by SDCERS. Therefore, no additional adjustment is required for this settlement (in contrast to the Corbett Settlement, which is a post-retirement adjustment).

c. Factors used in Calculating Actuarial Equivalents

Where necessary to calculate actuarial equivalents, the applicable mortality assumptions of GAM 83 through December 31, 2002, and thereafter GAR 94, pursuant to Rev. Rul. 2001-62, 2001-2 C.B. 632, were used. An eight percent (8%) interest assumption was used pursuant to SDMC § 24.0902 and Proposed Board Rule 8.41. However, a 5% interest rate was applied to post-retirement adjustments to the maximum dollar limit where benefits begin after the member reaches age 65.

d. Exclusion of Recipients of Ancillary Benefits

It has been determined that individuals who are receiving benefit payments that are not retirement benefits (such as pre-retirement disability and death benefits, post-retirement medical benefits) will be excluded from testing. For the pre-retirement disability benefits, SDCERS will still have to apply the 100% of compensation screen.

SDCERS also anticipates excluding all non-taxable disability benefits (these would be line of duty disability benefits). However, we note that an IRS ruling is necessary as to the status of these items and we are not aware that SDCERS has ever obtained such a ruling.

For the combined pre-retirement disability benefit and the pre-retirement death benefit, SDCERS will apply an incidental benefit test, the 25% of cost test. This will be in addition to, and separate from, the 415 limits.

2. <u>TAMRA Election</u>

SDMC § 24.1010(b) (*prior to pending amendment*) purports to make the TAMRA election for SDCERS benefits. However, the pending amendment to SDMC § 24.1004 would remove the language referencing the TAMRA election, as it is not clear that the requirements of the election were satisfied.

3. Age Adjustments Made in 415(b) Testing

a. Benefits After Age 65

For all members whose retirement benefit begins after age 65, the Dollar Limit was appropriately adjusted, as described in Exhibit A with respect to retrospective testing and Exhibit B with respect to prospective testing.

b. Benefits Before Age 62 – Other than Qualified Participants

For all members other than Qualified Participants whose retirement benefit begins before age 62, the Dollar Limit was appropriately adjusted, as described in Exhibit A with respect to retrospective testing and Exhibit B with respect to prospective testing.

c. Definition of Qualified Participants

As discussed above, the reduction in the dollar limitation for benefits which begin before age 62 does not apply to Qualified Participants. It is important to keep in mind that the group of public safety employees who may take advantage of this exception is not necessarily consistent with SDCERS' public safety member classification. For example, since EMTs were moved into the fire department several years ago, they could be included as a Qualified Participant (if they meet the service requirements). However, lifeguards were moved into the fire department fewer than 15 years ago; therefore, they do not clearly fall within the exception.

We note that the Proposed Regulations provide further guidance as to the public safety employees who may take advantage of the exception. Following is a suggested checklist for identifying Qualified Participants:

- Is the member credited in SDCERS with at least 15 years of service as an employee of any police department or fire department of the employer? If no, then apply pre-age 62 screen. If yes, proceed to next question. Note: The 15 years must be with an SDCERS employer, not via reciprocity.[4]

- Was the member a full-time employee of any police department or the fire department for all of those 15 years of service? If no, then apply pre-age 62 screen. If yes, do not apply pre-age 62 reduction. Count a person as a full-time employee of the department even if they are not a public safety officer. For example, if a person was a secretary in the fire department, they are a Qualified Participant. Service with the departments should be counted, including all periods of service, e.g., count such service that occurred before termination and reemployment. For example, if a member worked on probation for his first six months and then purchased that time, it should be included. A second example is a person who worked for one of the departments for three years, then left and took a refund. He then returned to the department and purchased those three years. They should be included.

[4] If the City plan, the Airport plan, and the Port plan are considered as separate plans, the Proposed Regulations may not permit combining service.

SDCERS staff has asked whether this exception for public safety officers requires that all fifteen (15) years of service be with the same department, or whether the service might be spread among two or more departments. In addition, SDCERS staff has asked whether police and military service can be combined to meet the 15-year requirement. The language of the Code and related regulations are very ambiguous on this point. While the Code language requires fifteen (15) years of service for any police or fire department organized and operated by the governmental employer maintaining the plan or military service, the Proposed Regulations require service either for any police or fire department or military service. Therefore, we are unable to opine on this point, although we believe that the IRS should accept any combination of public safety and military service in reaching the 15 year mark. We therefore are comfortable with the testing being done using the combination of all San Diego police and fire department service and military service. The IRS, of course, may request a different approach in the VCP filing on Code Section 415(b).

Park Rangers, who are not in the police department, but who exercise police powers in the City parks will not be treated as qualified participants, as agreed during the VCP process.

d. Exclusion of Pre-Age 62 Reduction for Disability or Death Benefits

The pre-age 62 reduction would not be applied to a SDCERS disability benefit or to a death benefit.

4. 10-Year Adjustment

SDCERS must identify those retirees who have fewer than ten (10) years of service with SDCERS, exclusive of reciprocity and exclusive of service purchases. Those retirees would have a reduced 415(b) test amount – for example, if the retiree only had five (5) years of service with SDCERS (exclusive of reciprocity and service purchases), the retiree's age-adjusted limit would be 50% of the age–adjusted limit. The limit can never be lower than 10% of the otherwise applicable limit. We realize this could create failures because of several design elements (i.e., the Port and Airport Plans have a five year vesting schedule, reciprocity provisions that allow for crediting service in other plans, a pre-1992 group who had less than 10 years of service but were vested as a mandatory retirement age group, and the SPSP "5+5" group). These adjustments are described in Exhibit A with respect to retrospective testing and Exhibit B with respect to prospective testing.

C. AMOUNTS EXCLUDED FROM TESTING

Following is a discussion of the elements that have been considered for exclusion in the screening and testing process.

1. After-Tax Employee Contributions

For 415(b) testing purposes, the portion of the annual benefit that is attributable to after-tax employee contributions may be "subtracted" from the annual benefit. In order to perform this calculation, SDCERS would have to be able to identify mandatory employee contributions that were made prior to the adoption of the pick-up and any voluntary post-tax contributions (including after-tax contributions for service purchases). However, based upon the changes

made by the PPA with regard to service purchases and the difficulty in performing 415(c) testing, we ultimately recommend that in the testing protocol the benefit attributable to after-tax employee contributions not be excluded from 415(b) testing, which would be consistent with Code Section 415(n) testing.

a. Mandatory Employee Contributions

SDCERS implemented a pick-up of mandatory contributions in 1987[5] for all contributions made by the employer. Prior to that time mandatory employee contributions were made on an after-tax basis; therefore, under the IRS regulations the benefit attributable to those mandatory contributions would be excludible from 415(b) testing. However, if those mandatory contributions exceed the 415(c) limits, the benefit attributable to the excess contribution would not be excludible. These pre-87 contributions will only be "backed out" from the 415(b) testing in cases where a failure has been identified in the testing group under the prospective methodology. The initial screen will leave them in.

b. Voluntary USERRA Contributions

It is our understanding that USERRA contributions are subtracted from any differential pay for the member. However, if the member did not receive differential pay, the member would be given the opportunity to pay those contributions on an after-tax basis. Therefore, SDCERS would be permitted to exclude the benefit attributable to the post-tax USERRA contributions from 415(b) testing, if the post-tax USERRA contributions would not have exceeded the 415(c) limits in the year of service.

c. DROP Contributions

SDMC § 24.1404(c)(4) provides that DROP contributions are made pursuant to a 414(h) pick-up. Therefore, the benefit attributable to these contributions would be included in 415(b) testing.

d. Voluntary Contributions for Permissive Service Credit Purchases; Missed Contributions

As noted above, the amount contributed for permissive service credit may either be tested under a modified 415(c) or 415(b) test. SDCERS will use the modified 415(b) test.

When SDCERS has determined that contributions have not been remitted for a period of service, the member is "billed" for these contributions as a pre-condition for receiving credit for that period of service. If those missed contributions are paid by the member with after-tax dollars, those contributions would be tested under Code Section 415(n) using the modified 415(b) test.

As a result of the PPA, all SDCERS service purchases would be considered to be permissive service credit purchases. As a result, those service purchases will be tested under the modified 415(b) testing of Code Section 415(n).

[5] This date was provided by staff on 12/7/2005.

e. Proposed Correction Approach

The proposed correction approach for retrospective testing does follow 415(b) testing with respect to after-tax contributions made for permissive service purchases under Code Section 415(n). See Exhibit A. The expanded testing of the pre-1995 Group will consider mandatory after-tax employee contributions (pre-pick-up).

Starting with January 1, 2007, and on a prospective basis, 415(n) testing will be applied for all permissive service purchases.

We also recommend, as a going-forward matter, that SDCERS keep a record of the type of service purchased and the source of the purchase. This will be done by reprogramming PensionGold (the SDCERS operating system).

PensionGold currently has fields with drop down selections that are used to identify the sources of money received for the payment of Purchase Service Contracts:

Payment Type Choices:

401k Transfer
Balance Adjustment
Cashless Transfer[6]
Lump Sum Payment
Manual
Rollover
SPSP Transfer
Transmittal

If the Rollover option is selected as the Payment Type, the "Rollover information" section is enabled. This section has a "Type" field with the following selection options:

401(k)
403(b)
457
Individual Retirement Account
Other Qualified Plan

Other fields in the Rollover information section include:

Acct. Name
Acct. Number
Acct. Holder

Each Payment received is identified in the system as "Pre or Post tax," as well as tied directly to a specific contract which identifies the service purchase type.

[6] This type of transfer is addressed in a separate VCP filing and Report.

To provide for accurate prospective 415(n) testing, we recommend that an additional payment type be identified as 457(b) or 403(b) direct transfer to identify those situation where permissive service credit is being purchased. We also recommend that the specific type of service being purchased be identified so that it can be determined that an appropriate source of funding was used.

2. Rollovers

The amount of the annual benefit that is attributable to rollovers may be excluded from 415(b) testing. As noted above, the benefit attributable to a rollover must be calculated in a manner permitted by the IRS. The properly calculated benefit attributable to the rollover could be "subtracted" from the annual benefit for testing purposes. Appropriate conversion factors for rollover purchases will be utilized.

3. Transfers from a Qualified Plan

With regard to transfers from a qualified defined contribution plan, the amount attributable to the transfer would be excludible from 415(b) testing using IRS prescribed factors. However, if there is a transfer from another defined benefit plan where aggregation is required (because, for example, the plans are maintained by the same employer or related employers), then the total benefit would be tested under 415(b). If the transfer is not from a defined benefit plan where aggregation is required, then the benefit attributable to the transferred amount could be "subtracted" from the annual benefit for testing purposes. Appropriate conversion factors for transfers in this situation will be utilized. **Note:** In this case, the employers participating in SDCERS do not maintain another defined benefit plan.

4. Transfers from a 403(b) or 457(b) Plan

Current IRS guidance does not directly address a transfer from a 457(b) or 403(b) plan for testing purposes. Retrospectively, we are not backing out 457(b) and 403(b) transfers. Prospectively, the chart below will be followed.

5. Purchase of Service Chart

The following chart identifies the various purchases that may be made under the Municipal Code[7] and our assessment of whether they would appropriately be categorized as permissive service credit – qualified or non-qualified – and the types of contributions that could be used for the purchase. For the category "permissive service," we are assuming that SDCERS assures that there is no double-counting of service and only one year of credit may be received for any 12 month period. For the category "sources" we are referring to whether all types of employee contributions can be made for the purchase – after-tax contributions under 415(n), rollovers, plan-to-plan transfers from a DC qualified plan, and plan-to-plan transfers from a 457(b) or 403(b) plan. With respect to transfers, the final 415 regulations may offer more guidance for prospective testing.

[7] Board Rules 10.00-10.40 describe Board policy with respect to the purchases that are set forth in the Municipal Code.

SDMC § /Type	Permissive Service	Qualified or Nonqualified	Sources	Treatment for 415(b) Purposes
Missed Contributions	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1301 – LTD	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1302 – Probation. Employee contributions only	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1303 – City Service	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1303 – 1981 Plan – waiting period	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1304 – Part-time, hourly pre 1/2/97	Yes (no double counting)	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1305 – Reinstatement – pre	Yes (no double counting)	Qualified	All	Back out benefit attributable to rollovers,

SDMC § /Type	Permissive Service	Qualified or Nonqualified	Sources	Treatment for 415(b) Purposes
1/2/97	415(k) Service			DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1306 – Repayment of refunds – contributions plus interest	Yes 415(k) Service	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1307(a) – Approved leave (one year) by payment of "employee cost" for leaves that begin before 2/1/97	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1307(b) – Approved leave (more than one year) by payment of employee and employer cost for leaves that begin before 2/1/97.	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1307(c) – After 1/1/97, LTD, FMLA, leaves without pay.	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1308 – Field of Membership	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).
24.1309 – Military Service: USERRA service (Per	Yes	Qualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b)

SDMC § /Type	Permissive Service	Qualified or Nonqualified	Sources	Treatment for 415(b) Purposes
SDCERS, this only covers USERRA service.)				transfers, based on IRS factors; use modified 415(b) testing under 415(n). **Note:** Electing this for convenience could be treated separately from all other service.
24.1312 – 5 year purchase – No period of service identified	Yes	Nonqualified	All	Back out benefit attributable to rollovers, DC and 457(b)/403(b) transfers, based on IRS factors; use modified 415(b) testing under 415(n).

6. 401(h) Amounts

Payments made from the 401(h) account do not count toward the Code Section 415(b) limit. Treas. Reg. § 1.415-3(d)(2)(ii). However, Code Section 415(l) provides that contributions allocated in an "individual medical account" shall be treated as an annual addition to a defined contribution plan, but are only subject to the 415(c) dollar limit (not the compensation limit).

However, it is our understanding there are currently no SDCERS reserves left to pay this 401(h) benefit. Consequently, retiree medical is either paid from other sources or not paid at all.

7. Aggregation of Payments to Alternate Payees

For purposes of 415(b) testing, SDCERS must aggregate payments to the member with any payments to alternate payees under the community property laws, including payments made pursuant to child support and spousal support orders. PensionGold was modified as of January 1, 2003, so that all payments made with respect to a member are "associated" with the member. In addition to payments to alternate payees, the "association" also includes deductions from the member's benefit such as an IRS levy. In order to have accurate 415(b) testing both prospectively and retrospectively, all "disassociated" payments must be associated with the appropriate SDCERS member. That "association" was done only with respect to the "initial failure" group of 89. (Please note that the initial group screen did include a 20% load for other than member payments.) Therefore, the total population has not been "associated." The 89 initial failures were "associated." Prospectively, SDCERS must "associate" all members when tested.

D. Classification of Employer Contributions

SDCERS staff has indicated that the SDCERS system does not track employer contributions as to what portion represents an offset contribution and what portion represents a pick-up (as Code Section 414(h)(2) defines the term) contribution. The result is that the benefit

attributable to any employer contribution (regular, offset, and pick-up) will be subject to 415(b) testing. This is the appropriate result under Code Section 415(b).

In order to enhance future compliance efforts, we strongly recommend that SDCERS and the plan sponsors use the term pick-up in the manner provided for in Code Section 414(h)(2).

E. QUALIFIED EXCESS BENEFIT ARRANGEMENT ("QEBA")

Ordinance No. O-18390, adopted on March 19, 2001, authorizes the establishment of a qualified governmental excess benefit arrangement (known as the Preservation of Benefit Plan) by SDCERS to pay benefits in excess of the Code Section 415 limitations. SDMC §§ 24.1601 to 24.1608 provide basic provisions regarding the establishment of a QEBA. SDCERS has established the QEBA through a separate plan/trust document containing detailed provisions regarding the plan. (Separate documents have been drafted for each plan sponsor.) This is covered in a separate report, and has been submitted to the IRS in a PLR request.

F. CONCLUSIONS REGARDING RETROSPECTIVE 415(b) TESTING

1. Definition of Tested Group – Post-1994 Group

In its original VCP, SDCERS, working with Ice Miller and Cheiron, developed a protocol for determining whether there have been 415(b) violations in prior years with respect to the group that retired on and after 1/1/95. This protocol began by identifying the entire population of 5530 retirees. That total was initially reduced by disabilitants who were not receiving a service retirement (490). After removal of 26 records reflecting deceased or suspended participants, this remaining group consisted of 2041 individuals, who were then tested under 415(b). See Exhibit A for the assumptions that were used in testing this group. This date (1/1/95) was selected for the following reasons:

From a Benefit Standpoint

1. The DROP benefit is one of the potential "causes" of 415(b) failures. The DROP benefit was initiated after January 1, 1995 (April 1997). Therefore, all DROP recipients are being tested under the new protocol.

2. Using the 1/1/95 date captures all of the Corbett and Andrecht settlement amounts.

3. Service purchases are another potential cause of 415(b) failures. The largest service purchase programs were initiated after January 1, 1995.

4. Multiplier increases are another potential cause of 415(b) failures. The most recent multiplier increases took effect in 1997 and 2002.

From the Code Standpoint

1. The grandfather provision enacted with Code Section 415(m) applies to benefits prior to January 1, 1995.

2. The grandfather provision enacted with Code Section 415(n) applies to any service purchase in effect on August 5, 1997.

2. Additional Testing Group – Pre-1995 Group

As a result of discussions during the VCP process, Cheiron has now developed a testing protocol for those SDCERS members who retired pre-1995. This is now reflected in Exhibit A.

3. Payments of Excess Benefits from the Preservation of Benefit Plan

After completion of the testing described in Exhibit A or B, the excess benefits of the affected individuals will be paid by the plan sponsors pursuant to San Diego Municipal Ordinance O-18930, March 19, 2001 (the "Ordinance"), which establishes the Preservation of Benefit Plan ("POB Plan") as a qualified governmental excess benefit arrangement within the meaning of Code Section 415(m).

SDCERS is pursuing a private letter ruling in order for the IRS to approve the POB Plan as a qualified excess benefit arrangement under Code Section 415(m) and to approve a rabbi trust for the POB Plan under Rev. Proc. 92-64, 1992-33 I.R.B. 11. In the interim, SDCERS has determined that it will seek direct payment from the plan sponsors of the excess benefits.

Once the POB is in place, SDCERS staff wants to use a "modified cliff approach." Under this approach, a retiree would be paid his/her full monthly benefit from the qualified SDCERS plan until the "modified cliff" date is identified. The modified cliff is determined by first identifying the amount of 415(b) excess for the year and determining how many months of benefits would have to be paid from the POB. Then, that amount is further adjusted to make sure that the member is receiving a portion of his/her benefit from the qualified plan in order that deductions from that benefit can continue.

A very simplified example demonstrates this approach: assume that a retiree is receiving a straight life annuity and has an excess benefit that equals 1/12 of his annual benefit. That would mean that he would receive 11 months of benefit from the qualified plan and one month of benefits from the POB. But if the retiree has a deduction from his benefit that equals ½ of his monthly benefit, then he would receive ½ of his monthly benefit from the qualified plan in month 11 and month 12 (in order to have dollars available for the deductions to take effect) and he would receive ½ of this monthly benefit from the POB in month 11 and month 12.

G. Conclusions Regarding Prospective Testing

1. Definition of Tested Group

Retrospective testing will cover benefits paid during the period of 1995 through June 30, 2006 (regardless of retirement date).

All members who retire on and after January 1, 2007, will be tested in accordance with the 415(b) protocols being developed by Cheiron, a draft of which is set forth in Exhibit B. To the extent information is available on pre-pick-up employee contributions, the after-tax contributions will be backed out for 415(b) testing.

2. "Screens" Used in Testing

Linea will build screens based upon PensionGold (the software used by SDCERS) fields.

3. Payments of Excess Benefits from POB Plan

Payments of excess benefits that result from prospective screening will be accomplished as stated above.

V.
OVERVIEW OF LAW WITH RESPECT TO DEFINED CONTRIBUTION LIMITS

Annual additions made or deemed to be made to a defined contribution plan are subject to the limits under Code Section 415(c). This test is applied on an annual basis and it is applicable to those governmental defined benefit plans that provide for after-tax employee contributions or certain purchases of service. Thus, after-tax employee contributions and after-tax payments for purchases of service are tested under the Code Section 415(c) limits, in the same manner as contributions to a separate defined contribution plan. Treas. Reg. § 1.415-3(d)(1).

A. THE DOLLAR LIMIT ON "ANNUAL ADDITIONS"

1. Current Limits

The defined contribution limits contain both a Dollar Limit and a percentage of compensation limit ("Percentage Limit"). EGTRRA increased the Dollar Limit for defined contribution plans from $35,000 to $40,000 for plan years beginning in 2002. This $40,000 dollar limit is subject to more rapid indexing, with annual cost of living adjustments in $1,000 increments instead of the current $5,000 increments.

Under prior law, the Percentage Limit did not permit contributions to exceed 25% of compensation. However, EGTRRA amended this limit for plan years beginning in 2002, and permitted annual additions to defined contribution plans of up to 100% of the participant's compensation, or $40,000 (as adjusted for inflation), whichever is less. For purposes of this definition, "compensation" includes both elective deferrals to a 401(k) plan or 403(b) plan and amounts contributed or deferred by the employer at the employee's election under a cafeteria plan, qualified transportation fringe benefit plan, or a 457 deferred compensation plan.

Certain contributions are not included in the definition of "annual additions" that are tested under Code Section 415(c). Mandatory employee contributions that are picked-up by an employer, or service purchase payments paid for by pre-tax (picked up) installment payments, simplify Code Section 415 testing because mandatory contributions or service purchase installment payments picked up pursuant to Code Section 414(h)(2) are not required to be treated as contributions to a separate defined contribution plan. However, the resulting benefit must be tested under Code Section 415(b) upon separation.

Additionally, Treas. Reg. § 1.415-6(b)(2) provides that a transfer of funds from one qualified plan to another is not an "annual addition" subject to testing under Code Section 415(c). Furthermore, Treas. Reg. § 1.415-6(b)(3) provides that the following types of contributions are not treated as employee contributions and thus are not "annual additions":

(i) Rollover contributions, and

(ii) The direct transfer of employee contributions from one qualified plan to another.

Additional exceptions from the 415(c) limits include USERRA contributions and restoration of forfeited benefits, which are discussed below.

2. The Limitation Year

The limitation year for 415(c) testing purposes will be determined (see page 16) in the same fashion as for 415(b) testing purposes.

The proposed regulations for Code Section 415(c) state the following with respect to the impact of a change in the 415(c) limits in the case of a plan that has a Limitation Year that is not the calendar year:

> The adjusted dollar limitation applicable to defined contribution plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Annual additions for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1. However, after a January 1 adjustment is made, annual additions for the entire limitation year are permitted to reflect the dollar limitation as adjusted on January 1.

Prop. Reg. § 1.415(d)-1(c)(2)(iii). Applying this proposed regulation to the SDCERS situation, we would come up with the following scenarios:

- If a member wished to contribute after-tax dollars during the time period July 1, 2006 through December 31, 2006, the member would be limited to a contribution of $44,000 (assuming that his compensation in that Limitation/Fiscal Year was equal to or greater than $44,000).

- If a member contributed an amount from $1 through $44,000 prior to January 1, 2007, the proposed regulation would permit the member to contribute the difference between the amount contributed prior to January 1 and $45,000 on and after January 1, 2007, through June 30, 2007. For example, if a member contributed $44,000 prior to January 1, 2007, on and after January 1, 2007, and through June 30, 2007, the member could contribute $1,000, under the proposed regulation.

3. Code Section 415(k)(3): Repayment of Cash-Outs

Section 415(k)(3) provides that any repayment of contributions (including interest) will not be taken into account for Code Section 415 purposes if the repayment is to a governmental plan with respect to an amount previously refunded on a forfeiture of service credit under that plan or any other governmental plan maintained by the state or any local governmental employer within the same state.

4. Testing of USERRA Service Purchases

Special Code Section 415 testing rules apply to the payment of contributions covered by the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"). Pursuant to Code Section 414(u)(1)(A) and (B), payments made in the applicable USERRA "make-up" period shall not be included in the Code Section 415(c) test for the limitation year in which the payment is made, and shall instead be allocated to the limitation year for which it relates. This rule exists to address a situation in which make up contributions permitted by USERRA for multiple years, in addition to the regular on-going contributions, were all made at once upon the return of a plan member on USERRA-approved leave. If the Code Section 415(c) limits were applied to the sum of these contributions, then a member might exceed the applicable limit.

In SDCERS' case, generally in "real life," the employee is being paid differential pay while on military leave, so their regular deductions for contributions remain as is (on a pre-tax basis). For the few employees who do not receive sufficient pay throughout the period to remain current on contributions, they are given options on how to restore contributions (e.g., lump sum installments). This group may need to be moved to an Exception Management process.

5. Code Section 414(v)

Code Section 414(v) provides that an "applicable employer plan" may permit an eligible participant to make additional elective deferrals in any plan year subject to certain limits. An "applicable employer plan" includes a 401(a) plan, a 403(b) plan, a SEP or a SIMPLE IRA, and a 457(b) plan. An eligible participant means a participant in the plan who will attain age 50 in the plan year and who would otherwise be "capped" out by other Code limitations. These additional elective deferrals may not exceed the lesser of the "applicable dollar amount" (for 2006 and thereafter this amount is $5,000) or the difference between the participant's compensation minus all other elective deferrals. For purposes of applying this limit, all 401(a) plans, 403(b) plans, SEPS and Simple IRAs of a single employer must be aggregated. Multiple 457(b) plans of a single employer must be aggregated, but are not aggregated with the other types of employer plans.

An additional elective deferral under Code Section 414(v) will not be subject to the otherwise applicable limitation under Code Section 401(a)(30), 402(h), 403(b), 408, 415(c), and 457(b) (determined without regard to 457(b)(3)).

Therefore, in determining whether an SDCERS member who makes an after-tax employee contribution is violating the 415(c) limits, the member's 415(c) limit is determined without regard to any additional elective deferral made under Code Section 414(v).

B. DEFINITION OF COMPENSATION

1. General Rule

Code Section 415(c)(3)(A) defines "participant's compensation" as "the compensation of the participant from the employer for the year." Code Section 415(c)(3)(D) includes as compensation elective deferrals under Code Section 402(g)(3) and amounts contributed by the employer at the election of the employee which are excluded from income under Code Sections 125, 132(f)(4), or 457.

Treas. Reg. § 1.415-2(d)(2) provides the following definition of compensation:

For purposes of applying the limitations of section 415, the term "compensation" includes all of the following:

(i) The employee's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan to the extent that the amounts are includible in gross income ....

***

(iii) Amounts described in sections 104(a)(3), 105(a), and 105(h), but only to the extent that these amounts are includible in the gross income of the employee.

Code Section 104(a)(1) excludes from gross income amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

2. Safe Harbor Definitions

There are at least three safe harbor options available to a plan for purposes of defining compensation for Code Section 415(c):

(1) Define compensation on a person by person basis, including all taxable income and certain items not included on Form W-2, imputed income items, etc. This approach has the advantage of producing the highest possible compensation amount for each individual, but is not administrable for a plan of any size. In order to take this approach, it would be necessary for SDCERS to determine the tax treatment of domestic partner health coverage and various other items.

(2) Define compensation based on the number reported by the employer as gross income in Box 1 of each employee's Form W-2. This approach results in a lower number than method 1, but is much easier to administer.

(3) Define compensation based amounts subject to federal income tax withholding, but excluding taxable reimbursements and the cost of group-term life coverage. This approach also results in a lower number than method 1, but is generally

easily available from the employer or payroll service provider and is therefore much easier to administer than an individualized approach.

3. Treatment of Workers Compensation

Plans often question how to treat workers compensation payments for purposes of the Code Section 415(c) definition of compensation. Generally, workers compensation payments are excluded from gross income, provided they are paid under a workers compensation statute, and therefore would not be includible as compensation under Code Section 415(c)(3). We believe this is true regardless of whether the employer is funding the payments directly or has paid for worker's compensation insurance, as in either case the amounts paid would (presumably) be paid pursuant to a worker's compensation statute.

There is a special rule under Code Section 415(c)(3)(C) which provides as follows:

> (C) SPECIAL RULES FOR PERMANENT AND TOTAL DISABILITY. In the case of a participant in any defined contribution plan—
>
> (i) who is permanently and totally disabled (as defined in section 22(e)(3)),
>
> (ii) who is not a highly compensated employee (within the meaning of section 414(q)), and
>
> (iii) with respect to whom the employer elects, at such time and in such manner as the Secretary may prescribed, to have this subparagraph apply,
>
> the term "participant's compensation" means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally disabled. This subparagraph shall apply only if contributions made with respect to amounts treated as compensation under this subparagraph are nonforfeitable when made. If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period, this subparagraph shall be applied without regard to clauses (ii) and (iii).

Treas. Reg. § 1.415-3(d)(1)-(3) provides that the voluntary and mandatory employee contributions (but not picked up contributions) under a defined benefit plan are treated as a separate defined contribution plan maintained by the employer, subject to the limitations on contributions of Code Section 415(c) and Treas. Reg. § 1.415-6. Thus, while Code Section 415(c)(3)(C) specifies its applicability to defined contribution plans, it could be argued that these provisions would be applicable to that portion of a defined benefit plan that is to be treated as a defined contribution plan.

There is very little guidance on the application of Code Section 415(c)(3)(C). Treas. Reg. § 1.415-2(d)(9) is reserved for "special rules for permanent and total disability," but no regulations have yet been issued. IRS Notice 83-10, which provided guidance regarding

amendments under the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), did provide a limited discussion on Code Section 415(c)(3)(C):

> TEFRA amended the definition of compensation to permit a defined contribution plan to include as compensation amounts not actually paid in the case of disabled employees who are not officers, owners, or highly compensated. In such a case, the rate of compensation earned immediately before disability can be imputed for the period of disability. However, any allocations based on this imputed compensation must be nonforfeitable. For example, an employee was compensated at the rate of $10,000 per year. On July 1, 1981, the employee received a raise that increased his salary to $20,000 per year. On December 31, 1981, the employee became permanently and totally disabled. Although the employee only received compensation of $15,000 for 1981, in computing the employee's rate of pay for 1982 the employee is deemed to have compensation at the rate of $20,000 per year.

The Small Business Job Protection Act of 1996 ("SBJPA") added the last sentence of Code Section 415(c)(3)(C) in order to extend its provisions to highly compensated employees, as explained by the Conference Report on the SBJPA:

> **Present law**
>
> Under present law, an employer may elect to continue deductible contributions to a defined contribution plan on behalf of an employee who is permanently and totally disabled. For purposes of the limit on annual additions (sec. 415(c)), the compensation of a disabled employee is deemed to be equal to the annualized compensation of the employee prior to the employee's becoming disabled. Contributions are not permitted on behalf of disabled employees who were officers, owners, or highly compensated before they became disabled.
>
> **House bill**
>
> The House bill provides that the special rule for contributions on behalf of disabled employees is applicable without an employer election and to highly compensated employees if the defined contribution plan provides for continuation of contributions on behalf of all participants who are permanently and totally disabled.

The Conference Report on HR 3448 (August 1, 1996) (emphasis added).

This special rule provides that in the case of an individual with a total and permanent disability, Code Section 415(c) compensation would be deemed to be compensation at the rate the employee was being paid prior to the disability. This then leads to the question of how this provision is applied. It is not clear whether Code Section 415(c)(3)(C) is really designed solely to provide an avenue for an employer to continue to make contributions to a defined contribution plan by imputing to a disabled employee the income that he earned prior to becoming disabled, or instead is definitional for 415 compensation purposes, thereby creating a base for applying the 415(c) limit.

In SDCERS' case, the City has industrial leave paid under the active payroll, with the possibility the person will go to a different payroll (i.e., workers compensation). This may require that a person in this situation be moved to an exception management process.

C. SERVICE PURCHASES

In our earlier report, we noted that one of our primary areas of concern with regard to 415(c) testing was with respect to service purchases. A voluntary employee after-tax contribution is subject to 415(c) testing unless the more advantageous provisions of Code Section 415(n) apply. However, the PPA has made 415(n) much broader so that the more favorable limits would apply to all SDCERS service purchases, subject to 415(n) limits.

As noted in an earlier section of the report, if an employee makes a voluntary contribution for a service purchase, the voluntary contribution may be tested under more generous 415(c) limits or 415(b) limits. The 415(c) limits under 415(n) are as follows:

> For purposes of Code Section 415(n) service purchases, only the dollar limit under Code Section 415(c) applies ($40,000 (adjusted for inflation)) by treating all permissive service contributions as an annual addition under that limit.

D. ANALYSIS OF ALL CITY PLANS

Code Section 415(g) requires the aggregation of all plans of an employer for 415 testing purposes. Therefore, our other primary area of concern for 415 testing occurs with respect to the other defined contribution plans that are maintained by the City – the 401(k) plan and the SPSP. The City's 457(b) deferred compensation plan is not aggregated with SDCERS.

VI.
APPLICATION OF CODE SECTION 415(c) TO SDCERS AND RECOMMENDATIONS

A. PLAN DOCUMENT PROVISIONS

SDMC § 24.1004(h) (*per pending amendment*) provides that employee contributions to, and benefits from, SDCERS must comply with the Code Section 415 limitations on contributions and benefits. The provision further establishes the fiscal year as the testing year, retrospectively, and the calendar year, prospectively. The amendment would permit SDCERS to modify contributions as necessary to ensure compliance with Code Section 415.

B. TESTING OF "ANNUAL ADDITIONS"

1. Plan Aggregation

Prior to 1/1/06, SDCERS has not tested annual additions against the Code Section 415(c) limitations. The City administers three defined contribution-type plans: the 401(k), SPSP, and a 457(b) plan. The City tests elective deferrals to the 401(k) and 457(b) plans. The City does not conduct Code Section 415(c) testing for its 401(a) plans (401(k), SPSP, and SDCERS). The other City plans and SDCERS are subject to qualification failure if the 415(c) testing

requirement is not satisfied and individuals are contributing in excess of the limitations to the plans in the aggregate. In order to address this qualification issue, SDCERS would have to coordinate with City to test for both the dollar and compensation limits under Code Section 415(c). In order to perform this test, SDCERS must select a definition of compensation that is permitted under the Code (see next section). The pre-tax (picked-up) contributions to SDCERS would not be used in the 415(c) testing.

If the after-tax contribution was made for a purchase of permissive service credit, Code Section 415(n) would apply and permit a higher level of contribution than under Code Section 415(c) or testing under 415(b).

The Airport and Port only offer a 457(b) plan; they do not provide a 401(k) or 401(a) plan. As a result, 415(c) testing for SDCERS purposes would not require aggregation with the Airport and the Port 457(b) plans.

2. Definition of Compensation

We discussed the three safe harbor definitions of compensation with SDCERS staff. Currently, none of the compensation fields provided by the City in Pension Gold represents any of the safe harbor definitions. SDCERS staff and the City have compared W-2 compensation used by the City with "gross compensation" reported as Gross Salary in Pension Gold. SDCERS staff has determined that the compensation numbers that are currently provided to SDCERS by the plan sponsors do not comport with any of the three safe harbor definitions. Therefore, for future testing purposes, it was determined that SDCERS would ask the plan sponsors to provide the Medicare wages amount from the W-2 system as a reasonable proxy for the safe harbor that starts with taxable wages and then restores elective deferrals.

Finally, please note that all plans which must be aggregated for purposes of 415(c) testing must use the same definition of compensation for those purposes. Therefore, if the plan sponsors are using a different definition of compensation for purposes of their testing, SDCERS must collaborate with them to arrive at a consistent approach.

C. Conclusions Regarding Retrospective 415(c) Testing

Given the 415(b) testing approach described in earlier sections of this Report, SDCERS is proposing not to do retrospective 415(c) testing for service purchases that fit within 415(n). This should be a reasonable approach considering the following factors:

- Since 1987, all mandatory employer contributions have been picked-up and thus would be subject to 415(b) testing.

- Since 1997, all service purchases made with after-tax employer dollars are subject to either modified 415(c) testing or modified 415(b) testing. SDCERS has elected 415(b) testing. The PPA has confirmed the availability of this methodology.

- Service purchases permitted as of August 5, 1997 are grandfathered and thus are not subject to 415(c) testing.

- For retrospective 415(b) testing, SDCERS is not backing out any after-tax employee contributions, except where information is available for mandatory post-tax contributions.

- Service purchases made via rollover and plan-to-plan transfer from the DC plans are not subject to 415(c) testing.

- Service purchases made by plan-to-plan transfers from the 457(b) plan are subject to regular 415(b) testing.

D. CONCLUSIONS REGARDING PROSPECTIVE 415(c) TESTING

Given the practical problems associated with 415(c) testing, SDCERS has determined to take the following prospective approach starting January 1, 2007.

1. Definition of Tested Group

The tested group will consist of all employees making after-tax contributions on and after January 1, 2007.

2. Testing of Service Purchases Made with After-Tax Employee Contributions

All service purchases made with after-tax employee contributions will be tested under the modified 415(b) testing under 415(n) if the service being purchased is permissive service, including qualified and nonqualified service, in accordance with the chart above. This means the benefit attributable to these contributions will not be tested under 415(c).

3. Testing of Other After-Tax Employee Contributions

SDCERS does not anticipate that any after-tax contributions would be received that did not qualify as contributions for the purchase of permissive service credit. Therefore, all would be tested under 2 above. However, SDCERS is retaining an "exception test" procedure for 415(c) in case SDCERS wishes to use the modified 415(c) testing in the future for service purchases or if other conditions arise which would require it (such as a change in the law).

4. USERRA Testing

In the case of USERRA contributions, the 415(c) limits that would be examined would be the limits in place with respect to the covered service – not necessarily the year of the payment.

5. Compensation Definition

The compensation definition that will be used in 415(c) testing (if it is necessary) has been stated in the proposed amendment to SDMC § 24.1004.

6. Testing Protocol

The testing protocol for this is set forth in Exhibit D.

7. Priority

One issue raised in this context is that of "priority." That is, it is important that a clear priority be established among the different plans as to what will be reduced first, second, etc. in the event that annual additions exceed the Code Section 415(c) limitation. This priority list should include not just the different San Diego defined contribution plans, but also the different types of contributions possible to each of those plans.

- First, attempt the correction through the 401(k) program. The amount of excess contributions would be distributed to the member.
- If the amount of 401(k) contributions for the year is not enough for the correction, then the next plan to consider would be SPSP. However, in order to preserve the plan's status as the Social Security replacement plan, the amount of contributions available to be refunded would be limited to the voluntary contributions.
- If the amount in the SPSP available for refund was insufficient to make the correction, then the correction would have to be made from SDCERS. This could affect the member's service purchase.

E. Testing of Service Purchases – By Source

1. SDCERS Provisions

SDMC § 24.1310(a) provides that in order to purchase Creditable Service a member must pay an amount, including interest, determined by the Board before the effective date of retirement. This section goes on to provide as follows:

> (b) Subject to any limitations imposed by the Internal Revenue Code, such payments under section 24.1310(a) may be made by lump sum, installment payments, direct transfer to the Retirement System from any defined contribution plan maintained by the City of San Diego, or in such manner and at such time as the Board may by rule prescribe. Any sums

paid by a Member under section 24.1310 are considered to be and administered as Member contributions.

SDMC § 24.1310(b). The Board has adopted rules under this section, which the Board has recently amended to read as follows: **[DON'T THESE RULES NEED TO BE REVISED?]**

Rule 10.50 Methods of Payment.

(a) Subject to any limitations or conditions imposed by applicable tax laws and regulations, a member may pay for service credit by:

(1) lump sum,

(2) installment payments through payroll deduction,

(3) direct transfer to the Retirement System from any tax qualified defined contribution plan maintained by the City, Airport Authority or Unified Port District,

(4) rollover or direct transfer of funds from an eligible retirement plan,

(5) direct in-service transfer from an IRC 457(b) compensation plan or an IRC 403(b) plan, subject to Board Rule 10.60 (subject to prior approval by the IRS); or

(6) any other source allowable under federal law.

(b) The System will treat all amounts paid by members under this Division as member contributions.

(c) A member must complete all payments to purchase service credit before his or her effective date of retirement, entry into DROP, or termination of employment (in the case of a deferred retirement).

(d) If a member elects to make installment payments:

(1) the member must agree to an installment contract with a payment plan that includes the purchase cost plus installment interest,

(2) the payments must be made through payroll deduction,

(3) the payments must be at least $20 per pay period,

(4) the System will charge installment interest to the member's individual account using the actuarial assumed interest rate in effect at the time the installment contract is executed, and

(5) if making pre-tax payments, the member must complete the installment contract before he or she first becomes eligible to

service retire, unless the member acknowledges in writing the negative consequences of failing to do so. (See form SDCERS uses for this. See Exhibit L.)

Board Rule 10.50.

The Board has adopted Rule 10.60 to read as follows:

Rule 10.60 In-Service Transfer of Funds from a 457 Defined Compensation Plan to Purchase Service Credit.

(a) Purchase of Service Credit under General Five-Year Provision (Board Rule 10.10): A member may purchase service under Board Rule 10.10 (general five-year purchase) by an in-service plan-to-plan transfer from a 457(b) plan. No certification of corresponding service is required.

(b) Purchase of "Service-Connected" Service Credit. A member may purchase service-connected service credit under Board Rule 10.00 by an in-service plan-to-plan transfer from a 457(b) plan. No certification of corresponding service is required.

With this new Rule 10.60 in place, transfers from the 457 plan will be accepted for service purchases as described in (a) and (b). See PLR 200550042.

The Board Rules also provides for the terms of installment contracts in Board Rule 10.70. Based upon these rules, it is clear that SDCERS has attempted to avail itself of all methods of service purchases.

2. Compliance Testing Chart

The following chart shows how the available sources of voluntary employee contributions for service purchases should be tested under either Code Section 415(c) or 415(n). (Refer to the earlier chart for a categorization of service purchases as permissive service and as qualified and non-qualified service.)

Voluntary Employee Contributions for Service Purchases	415(c) Testing or 415(n) Testing
In-service transfers from DC Plans (401(k), SPSP)	415(c) limits (including 415(n) modified limits) do not apply. Regular 415(b) limits should be applied at distribution.
Lump sum after-tax employee contributions and installment contracts for after-tax contributions if for non-permissive service or for nonqualified permissive service credit in excess of limits	415(c) limits apply (lesser of $40,000 (adjusted) or 100% compensation in the year of purchase). These will be tested on an exception basis.
Lump sum after-tax employee contributions and	415(n) limits apply. Therefore, purchase

Voluntary Employee Contributions for Service Purchases	415(c) Testing or 415(n) Testing
installment contracts for after-tax contributions if for permissive service	will be tested under modified 415(b) limits. However, SDCERS may prospectively implement modified 415(c) testing procedure.
Picked-up employee contributions for installment contracts Note: A favorable IRS private letter ruling is the mechanism for obtaining approval for a pick-up of employee contributions for a service purchase.	415(c) limits (including 415(n) modified limits) do not apply. Regular 415(b) limits should be applied at distribution.
Lump sum rollovers from eligible plans (401(a), 457(b), 403(b), 401(k), 403(a) and IRAs)	415(c) limits (including 415(n) modified limits) do not apply. Rollovers only after separation from service except IRAs.
Repayment of refunded contributions	Under 415(c)(3), 415(c) limits will not apply. 415(b) limits will apply at distribution.
Lump sum transfers from 457(b)/403(b) plans	Limited to permissive service credit and restoration of service. 415(c) limits will not apply. 415(b) limits will apply. See Rule 10.60.

It is our understanding from SDCERS staff that the vast majority of service purchases are made by plan-to-plan transfer from the Employers' plans. However, all of the other mechanisms are used to some extent, including after-tax payments.

F. TESTING OF USERRA SERVICE PURCHASES

SDMC § 24.1309 addresses purchase of retirement credit for service in the armed forces. The provision specifies that for purchases made pursuant to a leave due to military service, the payment is treated as an annual addition for the limitation year to which it relates. In order to provide appropriate treatment of USERRA service purchases, SDCERS will need to work with Employers to determine USERRA eligibility. The problem of accurate USERRA reporting may be limited to only a few SDCERS members because most SDCERS members who are called to military service receive differential pay. It is the City's practice to deduct the member's contribution from the differential pay on a picked-up basis. As a result, most SDCERS members retiring from USERRA-covered service to employment do not need to make any contributions for the USERRA leave period.

CIRCULAR 230 DISCLOSURE

Except to the extent that this advice concerns the qualification of any qualified plan, to ensure compliance with recently-enacted U.S. Treasury Department Regulations, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including any attachments, is not intended or written by us to be used, and cannot be used, by anyone for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing, or recommending to another party any tax-related matters addressed herein.

Appendix A

Overview of Code Section 415 Proposed Regulations

DEFINED BENEFIT PLANS

- **Multiple annuity starting dates**. The Proposed Regulations provide new rules for determining the annual benefit under a defined benefit plan when there has been more than one annuity starting date (i.e., where the application of the Code Section 415(b) limit must take into account prior distributions as well as currently commencing distributions). Prop. Reg. § 1.415(b)-2. This would occur when a participant has received one or more distributions in limitation years prior to an increase in the accrued benefit occurring during the current limitation year or prior to the annuity starting date for a distribution that commences during the current limitation year. These rules may also apply when a benefit payment is increased as a result of plan terms applying a cost-of-living adjustment ("COLA") pursuant to an adjustment of the Code Section 415(b) dollar limit, unless the plan provides for application of a safe harbor methodology set forth in the Proposed Regulations for determining the adjusted amount of the benefit (see discussion below under cost-of-living adjustments).

  In the case of multiple annuity starting dates, the annual benefit subject to Code Section 415(b) testing is equal to the sum of the annual straight life equivalent annuity attributable to the following:

  1. the accrued benefit that has not commenced;

  2. the annual benefit determined for any distribution with an annuity starting date that occurs within the current limitation year and on or before the current determination date;

  3. the annual benefit determined for any remaining amounts payable under a distribution with an annuity starting date that commenced in a prior year; and

  4. the annual benefit attributable to prior distributions.

  Prop. Reg. § 1.415(b)-2(a)(3)(i).

  The annual benefit attributable to prior distributions is determined by adjusting the amounts of prior distributions to an actuarially equivalent straight life annuity commencing at the current determination date. The Proposed Regulations apply rules that are analogous to the rules for adjusting other benefits to determine the amount of the actuarially equivalent straight life annuity for purposes of determining the annual benefit attributable to prior distributions. Prop. Reg. § 1.415(b)-2(a)(3)(ii), (b).

  A prior distribution that has been entirely repaid to the plan (with interest) does not give rise to an annual benefit attributable to prior distributions. Prop. Reg. § 1.415(b)-2(a)(3)(iv).

In the case of a new election modifying multiple annuity payments that have already commenced, the payments made before the change plus the modified payments must satisfy the Code Section 415(b) limit in effect on the original annuity starting date, based on the assumptions applicable at that time. However, payment adjustments that reflect cost-of-living increases under Code Section 415(d) are ignored for this purpose.

- **Note**: The specific rules on the application of testing of multiple annuity starting dates are very complex. Ice Miller's comment letter focused on this area as a primary cause for concern and urges the Service to take a simpler approach to testing in this area. We believe the multiple annuity starting date proposed rules could impact a variety of common governmental plan features – ad hoc COLAs, 13th checks, DROPs, PLSOs, and plan amendments. We also think it also provides a difficult interaction with Code Section 401(a)(9) compliance.

- **Cost-of-living adjustments**.

  - IRS Limit Adjustments. The Proposed Regulations provide rules regarding application of the cost-of-living adjustments to the Code Section 415 limits. Prop. Reg. § 1.415(d)-1. The Regulations specify the circumstances under which an adjusted limit is permitted to be applied to participants who have previously commenced receiving benefits under a defined benefit plan. The adjusted limit would be applicable to current employees who are participants in a defined benefit plan and to former employees who have retired or otherwise terminated service and have a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive benefits. A plan may provide that the annual increase applies for a participant who has previously commenced receiving benefits only to the extent that benefits have not been paid, and a plan must specifically so provide in order for the increase to be effective. Prop. Reg. § 1.415(a)-1(d)(3)(v)(C).

    The Proposed Regulations provide a safe harbor under which the annual benefit will satisfy the limitations of Code Section 415(b) for the current limitation year following an adjustment to benefit payments that is made to reflect the IRS cost-of-living adjustment made under Code Section 415(d). If such adjustments are made in accordance with this safe harbor, the multiple annuity starting date rules will not apply with respect to such adjustment.

    An adjustment to a benefit for a COLA increase under Code Section 415(d) will be treated as being made under the safe harbor if (1) the participant has received one or more distributions that satisfy the requirements of Code Section 415(b) before the date the increase to the applicable limit is effective; (2) the adjusted distribution is solely as a result of an increase in the Code Section 415(d) limits; and (3) the amount payable to the employee for the limitation year and subsequent limitation years is not greater than the amounts that would otherwise be payable without regard to the adjustment, multiplied by a fraction, the numerator of which is the limitation under Code Section 415(b) in effect for the distribution following the Code Section 415(d) increase, and the denominator of which is such limitation

under Code Section 415(b) in effect for the distribution immediately before the increase. Prop. Reg. § 1.415(d)-1(a)(5).

- Plan Benefits with Fixed COLAs. Last year the IRS issued PLR 200452039, which provided that a plan benefit with an automatic COLA had to take into account the value of the COLA when testing the benefit under the Code Section 415(b) limit. Under the Proposed Regulations, there is an example under which the plan had to reduce the benefit limit to recognize the value of any automatic, fixed COLAs provided under the plan. Prop. Reg. § 1.415(b)-1(c)(5), Example 6.

- **Benefit tested under 415(b)**. The Proposed Regulations prohibit both the payment and accrual of a benefit in excess of the Code Section 415(b) limits. Prop. Reg. § 1.415(b)-1(a)(1) (3). In the past, this Code Section has generally been interpreted for governmental plans as requiring that benefits paid, not just accrued, must meet the 415(b) limit.

  - **Note**: Our comment letter to the Service raises the problems with this issue, including an overarching concern with the focus of the Proposed Regulations on the accrual concept versus the benefit payment concept, noting the inherent difficulties this would present for governmental plans. We really think this is the "heart" of the problem with the Proposed Regulations. Without a different reference point (at least for governmental plans), compliance will be very problematic.

- **Dollar limit applicable to early or late retirement**. Code Section 415(b)(2)(C) provides that the dollar limit must be actuarially reduced when benefits begin before age 62. The Proposed Regulations generally use the plan's determinations for actuarial equivalence of early retirement benefits, but override them when the use of the specified statutory assumptions results in a lower limit. Prop. Reg. § 1.415(b)-1(d).

  If the benefit is not forfeited at the member's death, there is no adjustment to the dollar limit with respect to mortality to reflect the probability of the member's death between the annuity starting date and age 62 (which results in a higher dollar limit than if mortality were considered). The Proposed Regulations allow a plan to treat a benefit as not being forfeited if the plan does not charge members for providing a qualified pre-retirement survivor annuity, but only if the plan applies this treatment for adjustments before age 62 and after age 65. Prop. Reg. § 1.415(b)-1(d)(2).

  Pursuant to Code Section 415(b)(2)(I), the dollar limit is not adjusted for commencement before age 62 for a distribution from a governmental plan on account of the participant becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant. Prop. Reg. § 1.415(b)-1(d)(4). Similarly, the less than ten years of participation reduction does not apply to such benefits. Prop. Reg. § 1.415(b)-1(g)(3).

  The Proposed Regulations similarly provide for the dollar limit to be actuarially increased for benefits that begin after age 65. However, if the plan does not actuarially increase benefits in the case of later retirement age, the dollar limit adjustment is not permitted.

Prop. Reg. §§ 1.415(a)-1(d)(3)(v)(C); 1.415(b)-1(e). A National Council on Teacher Retirement representative testified on this point at the August 17 hearing, urging the Service to reconsider this approach.

- **Conversion of benefits to straight life annuity**. The Proposed Regulations provide rules under which a retirement benefit payable in any form other than a straight life annuity (or qualified joint and survivor annuity ("QJSA")) is converted to the straight life annuity that is actuarially equivalent to that other form to determine the annual benefit used to show compliance with Code Section 415 for that form of distribution. The Proposed Regulations reflect statutory changes that specify the actuarial assumptions to be used for these equivalency calculations. Prop. Reg. § 1.415(b)-1(c).

  For a form of benefit that is not subject to the minimum present value rules of Code Section 417(e) (which includes any governmental plan benefits), the straight life annuity payable under the plan at the member' current age (not the straight life actuarial equivalent of the selected benefit form using the plan's actuarial assumptions) is compared to the straight life annuity that is the actuarial equivalent of the optional form of benefit, determined using specified statutory assumptions, and the larger of the two straight life annuities is used as the annual benefit subject to 415 testing. Prop. Reg. § 1.415(b)-1(c)(2). .

  - Note: Ice Miller's comment letter addresses the issue of the appropriate actuarial assumptions that should be used for this conversion.

- **Benefit forms for which no adjustment is required**. The survivor portion of a benefit that is a QJSA is not taken into account in determining the annual benefit subject to 415(b) testing. The Proposed Regulations provide that this exception will apply to any portion of a benefit that is paid as a QJSA, even if another portion of the benefit is paid in some other form (for example, a partial lump sum). Prop. Reg. § 1.415(b)-1(c)(4)(i)(A), (ii)(B).

  Further, ancillary benefits not directly related to retirement benefits are not taken into account for purposes of Code Section 415(b) testing. Prop. Reg. § 1.415(b)-1(c)(4)(i)(B).

- **Exclusion of annual benefit attributable to mandatory after-tax employee contributions**. The Proposed Regulations retain the rules under the existing regulations that the annual benefit does not include the annual benefit attributable to mandatory employee contributions (which are not picked-up). Prop. Reg. § 1.415(b)-1(b)(1)(ii).

  The Regulations provide that the annual benefit attributable to mandatory employee contributions is determined using the factors described in Code Section 411(c)(2)(B) and (C) and the regulations thereunder, regardless of whether Code Section 411 applies to the plan (which such Section does not apply to a governmental plan). Prop. Reg. § 1.415(b)-1(b)(2)(iii). Mandatory employee contributions (which are not picked-up) are treated as annual additions to a defined contribution plan for purposed of Code Section 415(c). Prop. Reg. § 1.415(c)-1(a)(2)(ii)(B) and (b)(3). Picked-up employee contributions are

treated as employer contributions to a defined benefit plan. Prop. Reg. § 1.415(b)-1(b)(2)(ii)(A).

- ➢ **Note**: In our comment letter to the Service, we have raised our concerns with the difficulties in applying the Code Section 411 methodology in the governmental plan context.

The Proposed Regulations provide that, if voluntary employee contributions are made to a plan, the portion of the plan to which such contributions are made is treated as a defined contribution plan under Code Section 414(k), not a defined benefit plan, and is not taken into account in determining the annual benefit under the portion of the plan that is a defined benefit plan. Prop. Reg. § 1.415(b)-1(b)(2)(iv).

The Proposed Regulations would clarify that picked-up contributions, loan repayments, the repayment of any amount previously distributed, and the repayment of withdrawn employee contributions, would not be treated as employee contributions. Prop. Reg. § 1.415(b)-1(b)(2)(ii).

The Proposed Regulations also provide that, in determining the amount of the annual benefit that is excluded from testing because it is funded by employee contributions, member repayments of withdrawn contributions, even if paid after-tax (and thus counted as basis) would not be treated as employee contributions.

- ➢ **Note**: This treatment does not seem consistent with Code Section 415(k)(3), which provides that repayments of previously withdrawn contributions, plus interest, are not subject to the Code Section 415 limits. Ice Miller's comment letter has raised this issue with the Service.

- **Exclusion of annual benefit attributable to rollovers**. The Proposed Regulations clarify that the annual benefit subject to Code Section 415(b) testing does not include the annual benefit attributable to rollover contributions made to a defined benefit plan (i.e., rollover contributions that are not maintained in a separate account that is treated as a separate defined contribution plan under Code Section 414(k)). Prop. Reg. § 1.415(b)-1(b)(1)(ii). In this situation, the annual benefit attributable to the rollover contributions is determined by applying the rules of Code Section 411(c), treating the rollover contributions as employee contributions, regardless of whether Section 411 applies to the plan. The Proposed Regulations specify that if a plan uses more favorable factors than those specified in Code Section 411(c) to determine the amount of annuity payments arising from a rollover contribution, the annual benefit under the plan would reflect the excess of those annuity payments over the amount that would be specified in Code Section 411(c). Prop. Reg. § 1.415(b)-1(b)(2)(v).

  - ➢ **Note**: This is an area upon which we have commented to the Service, arguing that the Code Section 411 rules, which are not generally applicable to governmental plans, should not be used in these circumstances; rather, we have proposed that public plans be permitted to use the plan actuarial factors in this

circumstance. We have also asked the Service to provide an example of a defined benefit plan to a defined benefit plan rollover.

- **Treatment of benefits transferred among plans**. Under the current Code Section 415 Regulations, if a transfer is from one qualified plan to another qualified plan, the annual benefit attributable to the transferred assets is not taken into account by the transferee plan. Treas. Reg. § 1.415-3(b)(1)(iv). Further, a transfer from one qualified plan to another qualified plan is not an annual addition in the year of the transfer. Treas. Reg. § 1.415-6(b)(2)(iv).

  The Proposed Regulations attempt to provide further detail on the treatment of transfers between qualified plans, presumably to address concerns by the Service that funds are being transferred between plans without ever ultimately being tested in some fashion under Code Section 415. The Proposed Regulations view transfers on a defined benefit plan to defined benefit plan and defined contribution plan to defined contribution plan basis. The Proposed Regulations would modify the rules of the existing Final Regulations for determining the amount of transferred benefits that are excluded from the annual benefit under a defined benefit plan in the event of a transfer from another defined benefit plan. Prop. Reg. § 1.415(b)-1(b)(3).

  In the case of transfers between defined benefit plans subject to the plan aggregation rules (i.e., the annual benefit under both plans must be combined for purposes of Code Section 415 testing), the transferred benefits are included in determining the annual benefit under the plan receiving the transfer (the transferee plan) and are disregarded in determining the annual benefit under the transferring plan (the transferor plan). Thus, under each plan, the annual benefit is determined taking into account the actual benefits provided under that plan after the transfer. Prop. Reg. § 1.415(b)-1(b)(3)(A).

  In the case of transfers between non-aggregated defined benefit plans, the benefits associated with the transferred liabilities (other than surplus assets) are treated by the transferor plan as a single sum distribution (which presumably is tested under the Code Section 415(b) limit). Although such a transfer is treated as a distribution in computing the annual benefit under the transferor plan, no corresponding adjustment to the annual benefit under the transferee plan is made to reflect the fact that some of the benefits provided under the transferee plan are attributable to the transfer. Thus, the actual benefit provided under the transferee plan is used to test the annual benefit under the transferee plan, even thought the transferred amount is included as a distribution in determining the annual benefit under the transferor plan. Prop. Reg. § 1.415(b)-1(b)(3)(B).

  In the case of transfers between defined contributions plans, the transfer is not treated as an annual addition.

  Thus, transfers between defined benefit and defined contribution plans are not specifically addressed under the Proposed Regulations; in particular, the difficult issue is a transfer from a defined benefit to a defined contribution plan. Hopefully, the Final Regulations will provide some clarity to this issue.

- **Application of $10,000 exception**. The benefits payable to a participant will satisfy Code Section 415(b) if the benefits payable to that participant under the plan and all other defined benefit plans of the participant do not exceed $10,000 for the plan year or for any prior plan year, and the employer has not at any time maintained a defined contribution plan in which the participant participated. Thus, for example, a distribution for a limitation year that exceeds $10,000 will not fall in this exception, even if it is a single-sum distribution that is the actuarial equivalent of an accrued benefit with annual payments that are less than $10,000. Prop. Reg. § 1.415(b)-1(f).

- **Less than 10 years of participation**. The dollar limit is reduced pro-rata if a participant has fewer than 10 years of participation in the plan. This reduction does not apply to a distribution of survivor or disability benefits from a governmental plan. Prop. Reg. § 1.415(b)-1(g).

- **QDRO payments**. For purposes of Code Section 415, benefits provided to an alternate payee under a QDRO are treated as if provided to the member. Prop. Reg. § 1.415(a)-1(f)(5).

DEFINED CONTRIBUTION PLANS

- **Timing of contributions**. The Proposed Regulations would modify the deadline for making employer contributions to a plan that are credited to a participant's account for a limitation year for purposes of Code Section 415(c). Under the Proposed Regulations, the deadline for a tax-exempt employer to make a contribution to the plan that is credited to a participant's account for a limitation year for purposes of Code Section 415(c) is the 15th day of the tenth calendar month following the close of the taxable year with or within which the particular limitation year ends. Prop. Reg. § 1.415(c)-1(b)(6)(B).

  - **Note**: This is an extension from the earlier deadline now applicable under the existing regulations (the 15th day of the sixth calendar month following the close of the taxable year with or within which the particular limitation year ends).

  As under the current Regulations, employee contributions may not be included in a limitation year unless they are actually made to the plan within 30 days after the close of the limitation year. Prop. Reg. § 1.415(c)-1(b)(6)(C).

  The Proposed Regulations also confirm that employer make-up contributions made pursuant to USERRA, resulting from qualified military service, are not treated as an annual addition for the year in which the contribution is made, but are treated as an annual addition for the year to which the contribution relates. Prop. Reg. § 1.415(c)-1(b)(6)(ii)(D).

- **Definition of "Compensation."** The Proposed Regulations primarily reflect several statutory changes that were made to Code Section 415(c)(3) since the issuance of the existing Final Regulations. Among these changes are the inclusion in compensation of certain deemed amounts for disabled participants and nontaxable elective amounts for deferrals under Code Sections 401(k), 403(b), and 457, cafeteria plan elections under

Section 125, and qualified transportation fringe benefit elections under Code Section 132(f)(4). Prop. Reg. § 1.415(c)-2.

The Proposed Regulations also permit a plan to use a safe harbor definition of compensation, including Form W-2 wages or wages subject to income tax withholding. Prop. Reg. § 1.415(c)-2(d).

The Proposed Regulations also provide that the definition of compensation is subject to the Code Section 401(a)(17) limits, which is a departure from the generally accepted understanding of this rule. However, because governmental plans are not subject to the 100% of compensation limit under Code Section 415(b), this issue has little practical significance for public plans.

- **Compensation after severance from employment**. The Proposed Regulations provide specific rules regarding when amounts received following a severance from employment may be included as compensation for purposes of Code Section 415. Unlike the other provisions of the Proposed Regulations (which may not be relied upon until the Final Regulations are issued), these changes may be considered effective immediately for limitation years beginning on or after January 1, 2005. Prop. Reg. § 1.415(c)-2(e).

  Generally, the Proposed Regulations provide that amounts received after severance from employment are not considered compensation under Code Section 415, except for the following:

  - If made within 2½ months after a severance from employment, payments (such as regular compensation, overtime, bonuses, etc.) that would have been payable if employment had not terminated, and payments with regard to accumulated leave time that would have been available for use if employment had not terminated, may be included as compensation under Code Section 415. This exception would not include pure severance pay.

  Military differential pay, i.e., pay from an employer to an employee who is in qualified military service, may be included as compensation for purposes of Code Section 415.

  - ➢ **Note**: It is not clear from the Proposed Regulations how payments of regular salary which are made more than 2½ months after severance from employment would be treated. Ice Miller's comment letter asks the Service to clarify this issue.

- **Annual additions subject to Code Section 415(c)**. The Proposed Regulations clarify the definition of "annual additions" which are subject to Code Section 415(c) testing, which include employer contributions, employee contributions, and forfeitures. Prop. Reg. § 1.415(c)-1(b). Additionally, contributions to individual medical accounts that are part of a pension plan under Code Section 401(h) are treated as annual additions to a defined contribution plan (but such contributions are only subject to the dollar limit of Code § 415(c)). Prop. Reg. § 1.415(c)-1(a)(2)(ii)(C), (e). Annual additions do not

include rollovers, repayments under Code Section 415(k)(3), or transfers from another defined contribution plan. Prop. Reg. § 1.415(c)-1(b)(1)(iii). (b)(3).

- **Limitation year**. The Proposed Regulations set forth rules regarding the limitation year that generally correspond to the rules under the existing Regulations, and also provide specific guidelines with respect to overlapping limitation years for aggregated plans. Prop. Reg. § 1.415(j)-1.

  Where defined contribution plans with different limitation years are aggregated, Code Section 415(c) must be applied with respect to each limitation year of each such plan. For each such limitation year, Code Section 415(c) is applied to annual additions that are made for that time period with respect to the participant under all aggregated plans. Similarly, where defined benefit plans with different limitation years are aggregated, the rules of Code Section 415(b) must be applied with respect to each limitation year of each such plan. Thus, the dollar limit of Code Section 415(b)(1)(A) applicable for the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of Code Section 415(b).

RULES OF GENERAL APPLICABILITY

- **Combining and aggregating plans**. Under Code Section 415(f) and the Proposed Regulations, all defined benefit plans of an employer are treated as one defined benefit plan, and all defined contribution plans of an employer are treated as one defined contribution plan. Prop. Reg. § 1.415(f)-1.

- **No specific guidance under Sections 415(n) or 415(m)**. The IRS did not issue guidance with respect to the permissive service credit rules under Code Section 415(n) or qualified excess benefit arrangements ("QEBAs") under Code Section 415(m), but did ask for comments regarding the need for guidance on these provisions. In our comments to the IRS we did not request guidance on these statutory sections but did offer our observations on a few key issues in the event that the IRS does issue guidance.

INDEX OF EXHIBITS

NOTE: EXHIBITS C-L WILL BE EDITED AND FINALIZED POST AGREEMENT WITH IRS ON METHODOLOGY AND TERMS.

Exhibit A: Cheiron Report on Retrospective 415(b) Testing (Revised 3/20/07)

Exhibit B: Cheiron Report on Prospective 415 (b) Testing (Revised 3/20/07)

EXHIBITS

Eastus' Creditable Service Record	A.1
Employee Contribution Schedule	A.3
Actuarial Report Letter of Transmittal	C
Declaration regarding Cashless Leave	D.1
Budget Schedule	E.2(a)
Ordinance repealing 401(h) language	E.2(b)-1
Ordinance repealing § 24.1502(a)(5)	E.2(b)-2
VCP Supplement on Plan Document	G
Revised Technical Ordinance	H
Board Rule 8.41	H.4-1
Board Rule 8.80	H.4-2
Board Rule 8.90	H.4-3
DROP Board Rules	H.6
Litigation Update	I
Plan Update	J

DECLARATION

Under penalties of perjury, I declare that I have examined this submission, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of this submission are true, correct, and complete.

San Diego City Employees' Retirement System

By: Robert L Wilson Jr

Name: Robert L. Wilson Jr

Title: Assistant Retirement Administrator

Dated: 3/14/07

EXHIBITS

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DROP Board Rules	H.6
Litigation Update	I
Plan Update	J

CREDITABLE SERVICE RECORD

Name HARRY O. EASTUS Social Security [redacted]

Hire Date 04-13-73 Member date 04-13-73 Birthdate [redacted].49

(1101) Safety - Police

From	Thru	Type	If available for purchase, how paid	Transaction completed by (staffmember initials and date)
04-13-73	02-09-89	CORS		
02-10-89	06-28-96	LWOP	PAID = See	DCR on file
06-29-96	12-21-01	CORS		
12-22-01	04-12-02	CERS		

CSR completed by (staffmember initials) MARIE Date completed 1/14/04

Five-year purchase ☐ YES ☐ NO Purchase date_____ Staffmember initials_____ Date completed_____

Comments _____

Rev. 2/99

Exhibit A.1

DETAILED INFORMATION REGARDING PRESIDENTIAL LEAVE PARTICIPANTS

Affected Union Presidents	Garry Collins	James Farrar	Judith Italiano	Ron Saathoff	Harry Eastus
Union Time period	2/5/96 -4/28/00	2/5/00 -2/17/04	9/1/97 -8/13/04	7/1/2001 -6/30/03	2/24/89-6/28/967
Union Retirement Benefit					
Type	401K	401K		Not Eligible	No Participation
Employee Contributions	Yes	Yes		NA	NA
Union Contributions	Yes	Yes		NA	NA
Final Average Salary					
City	$ -	$	-	$	$
Union up to CAP	$	$		$	$ -
Total FAS	$	$		$	$
Union Contributions					
Union Contributions	$	$	$	$ -	
Employee Contributions				$ -	

NOTES:
Affected Union Presidents - Union members for which Unions paid, collected and forwarded retirement contributions to SDCERS.
DROP Status was removed as SDCERS did not accept contributions from the Unions while members were in DROP

Garry Collins - Employee Contributions of [redacted] were based upon his Union salary and deducted by the Union from his paycheck.
James Farrar - Employee contributions of [redacted] were based upon his Union salary and deducted by the Union from his paycheck.
Judith Italiano - Employee contributions of [redacted] were Transit P2P Transfer and personal check. No union deductions for her union salary.

[redacted]

Exhibit A.3

LETTER OF TRANSMITTAL

January 12, 2007

Board of Administration
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101

Dear Members of the Board:

At your request, we performed the June 30, 2006 actuarial valuation of the San Diego City Employees' Retirement System (SDCERS). The valuation results with respect to the City of San Diego are contained in this report. In the table below we present the key results of the valuation:

- the unfunded actuarial liability (UAL),
- the funding ratio, and
- the City contribution rate and GASB's annual required contribution (GASB ARC Statement No. 25).

Valuation results are shown as of June 30, 2006 (rates effective Fiscal Year 2008) and June 30, 2005 (rates effective for Fiscal Year 2007). The contribution rates and dollar amounts shown below are in full compliance with Governmental Accounting Standards Board (GASB) Statement No. 25 as far as determining the annual required contributions (ARC).

Table I-1
SDCERS - City of San Diego

Valuation Date	6/30/2006	6/30/2005
Unfunded Actuarial Liability (millions)	$ 1,000.8	$ 1,394.0
Funding Ratio	79.9%	68.2%
Fiscal Year	**2008**	**2007**
City Contribution Rate during year	24.95%	28.06%
City Contribution Rate start of year	24.01%	27.00%
Annual Required Contribution (GASB):		
-if paid at the beginning of the year	$ 137.7 million	$ 162.0 million
-if paid throughout the year	$ 143.1 million	$ 168.3 million

These results are based on the same actuarial assumptions used in the June 30, 2005 valuation, but reflect methodology changes that the Board approved based on Cheiron's on-going actuarial funding study and recommendations. Details on these methodology changes and their impact on the June 30, 2006 valuation results can be found in the Board Summary section.

Exhibit C

8200 Greensboro Drive, Suite 1125, McLean, VA 22102 Tel: 877.CHEIRON (2434766) Fax: 703.893.2006 www.cheiron.us

Fiscal Year 2008
Budget Development Calendar Overview

Below is an overview of the budget development calendar which reflects general target dates for completion. As additional budget dates become solidified, the dates will be posted for department analysts on the Financial Management Intranet site. Contact your assigned Financial Management liaison analyst if you have any questions.

Fiscal Year 2008 Proposed Budget development process	October – April 13th
Departments develop Fiscal Year 2008 budget proposals	December 11th – January 9th
Budget review meetings with Deputy Chiefs	January 9th – February 2nd
Council budget priorities resolution adopted	February 1st
Deadline for restructure requests – all departments	**February 2nd**
Executive Team budget meetings	February 12th – March 2nd
General Fund balancing – no changes after this date	**March 5th – March 7th**
Fiscal Year 2008 Proposed Budget established	**March 7th**
Completion date for the Fiscal Year 2008 Proposed Budget document	March 29th
Fiscal Year 2008 Proposed Budget release date	**April 13th**
Mayor presents the Fiscal Year 2008 Proposed Budget to City Council	**April 16th**
Budget Committee Meeting	April 18th (Council invited)
City Council budget hearings/referrals process	April 18th – June 11th
Community forum: special evening Budget Committee/City Council meeting	April 25th
IBA Preliminary Budget Report issued	April 27th
Mayor's Recommended Revision Report issued	May 16th

City Council budget priority memoranda issued	May 16th
Full Council deliberations on Budget	May 21
IBA report on recommended changes to the Mayor's proposed budget issued	June 1st
Budget Committee considers final modifications to the Mayor's budget	June 6th
Full City Council decisions on final budget modifications	June 11th
Mayor's veto period begins	June 12th
Mayor's veto period ends	June 19th
Appropriation Ordinance presented to City Council	July

*The City of San Diego Charter (Article XV, Section 265, Item b15) states the Mayor must propose a budget to Council and make it available for public review, no later than April 15th. The Mayor's Fiscal Year 2008 Proposed Budget is schedule for release on Friday, April 13, 2007.

STRIKE-OUT/REDLINE

OLD LANGUAGE – ~~STRIKEOUT~~
NEW LANGUAGE – *UNDERLINE/ITALICS*

(O-2007-__)

STRIKEOUT ORDINANCE NUMBER O-_____ (NEW SERIES)

ADOPTED ON _____

Article 4: City Employees' Retirement System

Division 8: City's Contribution

§24.0801 City's Contribution

~~The City will contribute to the Retirement Fund, on behalf of Members employed by the City, the amounts agreed to in the governing Memorandum of Understanding between the City and the Board.~~ *Based upon the advice of the Actuary, the Board will separately determine and adopt* ~~The San Diego City Employees' Retirement Actuary separately determines of the Board of the San Diego City Employees' Retirement System,~~ *the City's employer* contributions for General Members, Safety Members and Elected Officers. All deficiencies that occur due to the adoption of any Retirement Ordinances must be amortized over a period of thirty years or less. ~~The portion of the contribution that the City designates for the 401(h) Fund or the Health Trust, to be used for retiree health benefits under Division 12, is not a deficiency within the meaning of this section.~~

§24.0802 City Contribution — Special Class Safety Members No change.

Division 12: Retiree Health Benefits

§24.1201 Eligible Retirees

(a) Effective August 1, 1997, two separate retiree health benefits are offered: one to Health Eligible Retirees and one to Non Health Eligible Retirees. ~~A Health Eligible Retiree is any General Member, Safety Member or Elected Officer who: (1) was on the active City payroll on or after October 5, 1980, (2) retired on or after October 6, 1980, and (3) is eligible for and is receiving a retirement allowance from the Retirement System. A Non Health Eligible Retiree is any retiree who: (1) retired or terminated City employment as a vested Member before October 6, 1980 and (2) is eligible for and is receiving a retirement allowance from the Retirement System.~~

(1) A Health Eligible Retiree is any General Member, Safety Member or Elected Officer who: (1) was on the active City payroll on or after October 5, 1980; (2) retired on or after October 6, 1980; and (3) is eligible for and is receiving a retirement allowance from the Retirement System.

(2) A Non Health Eligible Retiree is any retiree who either:

(A) retired or terminated City employment as a vested Member before October 6, 1980 and is eligible for and is receiving a retirement allowance from the Retirement System; or

(B) was hired by or assumed office with the City on or after July 1, 2005.

(b) No change.

(c) No change.

~~§24.1201.1 Non-Health Eligible Retirees~~

~~Members hired or assuming office on or after July 1, 2005, are non-Health Eligible.~~

§24.1202 **Retiree Health Benefits Defined** No change.

~~§24.1203 401(h) Fund Established~~

~~(a) All retiree health benefit payments by the 401(h) Fund will comply with all applicable federal laws, including section 401(h) of the Internal Revenue Code ("Code"). If there is a conflict between this Division and section 401(h) of the Code or regulations issued under that section, the Code and regulations govern.~~

~~(b) 401(h) Fund – Compliance with Applicable Provisions of the Code~~

~~(1) All health benefits under this Division will be paid solely from the 401(h) Fund until the 401(h) Fund assets are exhausted.~~

~~(2) No health benefits provided under the 401(h) Fund may discriminate in favor of highly compensated employees.~~

~~(3) The 401(h) Fund is a separate account solely for providing retiree health benefits. It is established and maintained by the Board to reflect the amounts the City contributes to pay retiree health benefits. The 401(h) Fund exists for record-keeping purposes only.~~

~~Amounts credited to the 401(h) Fund may be invested with other Retirement System funds set aside for retirement purposes, without identifying which investments are allocated to each account. But, earnings on each account must be allocated in a reasonable manner.~~

~~(4) The City contributes to the 401(h) Fund solely to pay health insurance premiums under this Division. Contributions will be reasonable, ascertainable, necessary and appropriate. Contributions will not exceed the amounts that would violate the Code requirement that health benefits be subordinate to the retirement benefits.~~

~~(5) When the City makes a contribution to the 401(h) Fund, it must designate in writing to the Board the portion of the contribution to be allocated to the 401(h) Fund for health benefits.~~

~~(6) No part of the 401(h) Fund may be used for any purpose other than paying health benefits under this Division. But, 401(h) Fund assets may be used to pay for necessary and appropriate administrative expenses related to retiree health benefits.~~

~~(7) Any amounts contributed to the 401(h) Fund that remain in the 401(h) Fund after all liabilities for retiree health benefits are satisfied, including benefits payable to existing Members in the future, will be returned to the City. The City will provide benefits to Health Eligible and Non Health Eligible Retirees equal to the returned amount.~~

~~(8) Section 24.1203 does not require separate accounts for key employees because no member of the Retirement System is a key employee under the Code.~~

~~(9) Assets attributable to any forfeitures of benefits payable by the 401(h) Fund will be used to reduce the City's contributions for retiree health benefits.~~

~~(c) The Board may adopt rules and regulations as necessary or appropriate to carry out the requirements of this Division.~~

§24.1203<u>4</u> Funding of Retiree Health Benefits

The retiree health benefits described in this Division will be paid from *<u>funds transferred by the City to SDCERS from any source of funds available to the City.</u>* ~~the following sources of funds in descending order of availability:~~

~~(a) the 401(h) Fund, until exhausted, and~~

~~(b) the City, directly, from any source available to it.~~

OLD LANGUAGE – ~~STRIKEOUT~~
NEW LANUGAGE – UNDERLINED

STRIKEOUT ORDINANCE NUMBER O-_____ (NEW SERIES)

ADOPTED ON _____

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, DIVISION 15, OF THE SAN DIEGO MUNICIPAL CODE, BY REPEALING SECTION 24.1502 AND AMENDING SECTIONS 24.1501, 24.1503, 24.1504, AND 24.1507, ALL RELATING TO ELIMINATION OF THE "WATERFALL"

§24.1501 Investment Earnings Received

Investment Earnings Received shall be determined on a cash basis, except that Investment Earnings Received shall be increased or decreased by the amount of the annual amortization of purchase discounts or premiums on interest-bearing investments earned in accordance with generally accepted accounting principles for financial reporting purposes. No subsequent changes in the method of accounting for the Retirement System shall affect the determination of Investment Earnings Received. ~~Surplus~~ Undistributed Earnings shall be determined by the City Auditor and Comptroller in accordance with this Section and shall be certified by the City's independent public accountant.

~~§24.1502 Surplus Undistributed Earnings~~

~~(a) Surplus Undistributed Earnings are comprised of Investment Earnings Received for the previous fiscal year, less:~~

~~(1) An amount sufficient to credit interest to the contribution accounts of the Members, City and the Unified Port District at an interest rate determined by the Board and distributed in accordance with Section 24.0904 and related Board rules; and~~

~~(2) An amount sufficient to meet the budgeted expenses and costs of operating the System including all personnel and services for the fiscal~~

Exhibit E.2(b)-2

~~(3) An amount necessary to maintain such reserves as the Board deems appropriate on advice of its investment counselor and/or Actuary; and~~

~~(4) An amount sufficient to credit Unified Port District ("UPD") with a proportional share of Surplus Undistributed Earnings as defined in this Section; and~~

~~(5) An amount, (the Division 12 amount), appropriate to provide health benefits to Health Eligible and Non Health Eligible Retirees as provided in Division 12 for the next fiscal year provided:~~

~~(A) in the next fiscal year, the City contributes to the 401(h) Fund no less than an equal amount which is designated to be used for retiree health benefits to be paid or reimbursed in the next fiscal year; and,~~

~~(B) to the extent the City makes a contribution to the 401(h) Fund for the next fiscal year, the Division 12 amount shall be treated as a portion of normal employer contributions paid to the Retirement System when the City so designates in accordance with Section 24.1203(b)(5); and~~

~~(6) An amount sufficient to provide necessary funds to pay an annual supplemental benefit to Qualified Retirees, pursuant to the provisions and conditions set forth in Section 24.1503. If, at the time of the annual determination, the amount provided for the supplemental benefits is less than $100,000, no supplemental benefits will be paid in that fiscal year and the monies will be placed in a special reserve and be carried forward to ensuing years until such time as the amount to be~~

~~provided for this benefit from ensuing Surplus Undistributed Earnings and the special reserve is $100,000 or more; and~~

~~(7) An amount sufficient to increase the Base Retirement Benefit by 7% for all retired City employees and Beneficiaries who are covered by the Corbett Settlement.~~

~~(A) The right to receive this increase each year will accrue monthly. But, the increase will be paid annually when the Annual Supplemental Benefit (13th check) is normally distributed. The increase will be paid, on a prorated basis, to the Beneficiary or estate of any retiree who dies during the fiscal year but before the annual payment is made.~~

~~(B) To the extent this increase is not paid in any year because there are insufficient Surplus Undistributed Earnings, the liability for this increase will be carried forward as a contingent liability which will be paid in future years in which there are sufficient surplus Undistributed Earnings to pay for the increase.~~

~~(C) Liabilities carried forward will be paid in the order in which they accrued.~~

~~(8) An amount sufficient to credit interest to the reserves created for Supplemental COLA and Employee Contributions as set forth in this Division.~~

~~(b) At the beginning of each fiscal year, the Board will credit all Surplus Undistributed Earnings to the Reserve for Employer Contributions, for the sole and exclusive purpose of reducing Retirement System liability.~~

§24.1503 Annual Supplemental Benefit - Qualification and Determination

The purpose and intent of this section is to provide necessary guidelines for effectuating the payment of annual supplemental benefits ~~set forth in Section 24.1502(a)(6)~~, by (a) identifying and defining those retirees qualified to receive such benefit, and (b) establishing a method for determining the amount of the annual supplemental benefit.

(a) For the purpose of identifying those retirees who shall be deemed qualified to receive the annual supplemental benefit established in this Section, the following criteria shall apply:

(1) The retiree must have completed a minimum of ten (10) years Creditable Service as a Member of the System in order to be qualified;

(2) The retiree must be on the retirement payroll for the month of October of any year in which benefits are to be paid except as provided otherwise in Section 3 of this ordinance for the first year's distribution;

(3) Qualified Retirees shall be limited to the following classes:

(A) Retired General and Safety Members;

(B) Retired Unified Port District Members; and

(C) Special Class Safety Members who are receiving fixed monthly retirement benefits; and

(D) Survivors of (a), (b) and (c) above receiving monthly pensions from the system, provided such members had met minimum continuous service requirement in subsection (a)(1) above.

(4) Legislative and Special Class Safety Members who are receiving fluctuating monthly retirement benefits, and the survivors of both classes

shall not be eligible for participation in the annual supplemental benefit program established by this Article.

(5) For the sole purpose of establishing eligibility for the Supplemental COLA described in Section 24.1504, Qualified Retirees may include those retirees with less than ten (10) years creditable service, including those who are receiving an industrial disability retirement from the System, those who have (10) years of continuous service with the System, survivors of Special Class Safety Members who are receiving fluctuating monthly retirement benefits, and survivors of special death benefit recipients.

(b) For the purpose of determining the amount of the supplemental benefit payment to Qualified Retirees, the following process shall apply:

(1) The Retirement Administrator each year shall identify all Qualified Retirees on the retirement payroll for the month of October.

(2) The Retirement Administrator shall then determine the number of years of creditable service possessed by each Qualified Retiree identified in 1. above.

(3) The number of creditable years for all Qualified Retirees shall be added together to determine the total sum of Qualified creditable years.

~~(4)~~ ~~The total sum of qualified creditable years shall then be divided into the total of Surplus Undistributed Earnings designated for distribution by the Board pursuant to Section 24.1502(a)(6) of this Section to arrive at a per annum dollar value for each creditable year, provided, however, that~~ In ~~in~~ no event shall the per annum dollar value exceed $30 (thirty dollars) except for those General Members who retired between January 8, 1982 and June 30, 1985, who shall be entitled to a per annum value not to exceed $45 (forty-five dollars).

Notwithstanding the preceding paragraph, and effective Fiscal Year 1997, Qualified Retirees who retired on or before October 6, 1980, but after

December 31, 1971, will receive $60 (sixty dollars) per year of service and Qualified Retirees who retired on or before December 31, 1971, will receive $75 (seventy-five dollars) per year of service.

(5) The per annum dollar value shall then be multiplied by each Qualified Retiree's creditable service to determine the annual supplemental benefit to be paid each Qualified Retiree the following November.

(6) Except as provided in Section 24.1503(b)(7), the supplemental benefits of survivors of deceased Qualified Retirees, as defined in Section 24.1503(a), shall be determined in the same ratio as their monthly benefits bear to the monthly benefit received by their respective deceased retired spouses.

(7) The supplemental benefit of a survivor of a Qualified Special Class Safety Retiree shall be determined by allocating to the surviving spouse fifty percent (50%) of the qualified creditable years issued to the deceased Member.

(c) The Board, with the cooperation and approval of the City Auditor and Comptroller, shall promulgate necessary rules to effectuate the provisions and intent of this Article.

§24.1504 Supplemental COLA Program

The purpose of the Supplemental COLA Program is to increase the retirement benefit of certain Qualified Retirees as defined in Section 24.1503 by an amount sufficient to insure that their benefit as of July 1, 1998, when combined with their Annual Supplemental Benefit as defined in Section 24.1503, is at a level equivalent to seventy-five percent (75%) of the present value of their Base Retirement Benefit. The amount of increase under this Section, however, shall not exceed fifty percent (50%) of the Qualified Retiree's benefit in effect as of July 1, 1998. For purposes of this section, the Base Retirement Benefit is the full monthly Retirement Allowance received upon retirement. The benefit in effect in July 1,

1998, is the benefit as defined in Section 24.0402, Section 24.0403 or Section 24.0405, as adjusted by both the Cost of Living Adjustment defined in Section 24.1505 and the Annual Supplemental Benefit, defined in Section 24.1503.

(a) Participation in the Supplemental COLA Program shall be limited to Qualified Retirees as defined in Section 24.1503 or their survivors, including special death benefit recipients, who:

(1) Retired on or before June 30, 1982; and (2) Received a retirement allowance on July 1, 1998, which, as determined by the System's Actuary, was at a level less than the equivalent of 75% of the present value of their Base Retirement Benefit when combined with their Annual Supplemental Benefit as defined in Section 24.1503.

(b) The amount to be paid as the Supplemental COLA benefit shall be calculated in accordance with the following procedures:

(1) The System's Actuary shall determine the factor necessary to calculate the equivalent of 75% of the present value of the Qualified Retiree's Base Retirement Benefit. This calculation shall be based on the Cost of Living Index as shown by the Bureau of Labor Statistics Consumer Price Index, United States - All items, for each applicable Fiscal Year.

(2) The above factor shall be multiplied times the Qualified Retiree's benefit in effect July 1, 1998, as defined above, but not including the Annual Supplemental Benefit, to determine the amount of the increase required under the Supplemental COLA Program.

(3) The amount of the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall not exceed 50% of the Qualified Retiree's benefit in effect as of July 1, 1998.

(4) The payment for the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall start in January, 1999, retroactive to July 1, 1998, with an amount for the months of July through December 1998 added to an increased January Retirement Allowance, and then monthly thereafter.

(5) The increase to the Qualified Retiree's Base Retirement Benefit calculated under the Supplemental COLA Program shall be paid to the Qualified Retiree or his or her survivor for life or until the Reserve established to pay this supplemental benefit is depleted.

(6) The Qualified Retiree's Retirement Allowance as increased by the Supplemental COLA Program shall be adjusted each July 1 thereafter in accordance with Sections 24.1505 and 24.1506.

(c) A reserve created by the Board pursuant to Section 24.1502(a)(3) shall be used to pay for the Supplemental COLA benefit as follows:

(1) The Reserve shall be credited with thirty-five million dollars ($35,000,000) from Undistributed Earnings for the Fiscal Year ending June 30, 1998.

(2) Benefit payments under the Supplemental COLA Program shall be accounted for separately and charged against this Reserve.

(3) The Reserve shall be credit with interest annually, if sufficient funds are available~~, in accordance with Section 24.1502(a)(7)~~.

(4) Benefit payments under the Supplemental COLA Program shall cease at such time as the Reserve is depleted.

(d) Reevaluation.

(1) The System's Actuary shall conduct an annual evaluation of the Reserve to determine the feasibility of expanding the Supplemental COLA Program to including additional retirees and their survivors, additional Funds in the Reserve or the recalculation of benefits annually.

(2) Prior to April 30th of each Fiscal Year, representatives of the City Manager's office, the Retirement Administrator, and representatives of eligible retired member of CERS, may meet to consider any recalculation of benefits, any increase in the number of Qualified Retirees or their survivors, or any increase in the Reserve created to pay the Supplemental COLA benefit. The factors for consideration are:

(A) The status of benefits of those retirees previously set at the 75% level;

(B) The status of benefits of those retirees previously capped at the 50% increase level;

(C) The status of retirees not previously eligible for the Supplemental COLA Program who now meet the necessary criteria;

~~(D) The amount of Surplus Undistributed Earnings available to provide such additional benefits;~~

(D) ~~(E)~~ The amount of the Annual Supplemental Benefit to be combined with the benefit in effect July 1, 1999, or as part of the Base Retirement Benefit.

§24.1505 **Cost of Living Adjustment Effective Date and Maximum Annual Change**

(a) The Board shall before July 1, 1971 and before each July 1 thereafter determine whether there has been an increase or decrease in the cost of living as provided in this section. Excepting those special class safety members whose retirement allowances are based upon 1/2 the amount of the current salary of their retired rank, every person receiving a monthly retirement allowance from this system on June 30, 1971 and each June 30 thereafter shall, on and/or effective July 1, 1971 and each July 1 thereafter, have his or

her monthly retirement allowance then being received increased or decreased by that percentage determined by the Board to approximate the nearest 1/10th of one percent of the percentage of annual increase or decrease in the cost of living which has occurred between the two previous January firsts, as shown by the Bureau of Labor Statistics Consumer Price Index, United States--All items. Such change, however, shall not exceed 2.0% per year and no decrease shall reduce the monthly retirement allowance below the amount being received by any person on the effective date of his or her retirement or the effective date of the application of this section, whichever is later. The amount of any cost of living increase or decrease in any year which is not met by the maximum annual change of 2.0% in allowances shall be accumulated to be met by increase or decreases in allowances in future years.

(b) The allowance of all persons who retired from the 1981 Plan shall be adjusted each July 1, following the third anniversary of the commencement of the allowance. The adjustment shall be equal to 50% of the change in the all Urban Consumer Price Index for the San Diego area — all items, except that such adjustment shall not exceed 10% annually. No adjustment shall reduce the allowance below the amount originally granted.

§24.1506 **Cost of Living Adjustment Program Shared Between Employer and Members**

(a) The cost of any anticipated cost of living increase in allowances which is based upon services rendered after July 1, 1971, shall be shared equally between the employer and the contributing Member, with the individual member's contributions based upon his or her age at his or her nearest

birthday at time of entrance into the Retirement System.

(b) Commencing July 1, 1971, and until adjusted by the Board upon the recommendation of the Actuary, the contribution requirements of Members as contained in Sections 24.0202 and 24.0302, respectively, plus surviving spouse contributions as contained in Section 24.0521, shall be increased by 15%. In addition, the contribution requirement for those Members specified therein who are active members on or after June 30, 1985, shall be increased by 20%. These "cost of living contributions" will be separately totaled upon the retirement of Members after July 1, 1971.

§24.1507 **Employee Contribution Rate Reserve**

(a) The Retirement Board created a reserve ~~under section 24.1502(a)(3)~~ to pay a portion of employee contributions (the "Employee Contribution Rate Reserve").

(b) The Employee Contribution Rate Reserve was created with $35,000,000 from Undistributed Earnings for the fiscal year that ended June 30, 1997.

(c) The Employee Contribution Rate Reserve will be credited with interest annually, if sufficient funds are available~~, in accordance with section 24.1502(a)(7)~~.

(d) The monies in the Employee Contribution Rate Reserve are not counted as part of System assets in the annual actuarial valuation.

(e) The Auditor and Comptroller will certify annually the amount of the anticipated City Payroll for the next fiscal year. Based upon this certification, at the beginning of each fiscal year, the Auditor will transfer an amount equal to .65% of the total City payroll from the Employee Contribution Rate

Reserve to the Employer Contributions Reserve.

(f) On a biweekly basis, based upon actual biweekly payroll, the Auditor will transfer from the Employee Contribution Rate Reserve to the Employer Contributions Reserve:

(1) an amount equal to 1.7% of the City payroll for Safety Members, starting at the beginning of the first full pay period after July 1, 2002,

(2) an amount equal to 1.6% of the City payroll for General Members, starting at the beginning of the first full pay period after July 1, 2003, and

(3) an amount equal to 1% of the City payroll for fire department and lifeguard employees who are Safety Members, starting at the beginning of the first full pay period after July 1, 2003.

(g) The amounts listed in sections 24.1507(e) and 24.1507(f) are cumulative.

(h) All transfers under section 24.1507 will be accounted for separately.

(i) Transfers under section 24.1507 will continue as long as there are sufficient funds remaining in the reserve.

MJA:ap
1/29/2007
Or.Dept:City Atty
O-2007-93 strikeout

Exhibit 12

ICEMILLER LLP
LEGAL COUNSEL

August 22, 2007

WRITER'S DIRECT NUMBER: (317) 236-2413
DIRECT FAX: (317) 592-4616
INTERNET: BRAITMAN@ICEMILLER.COM

WRITER'S DIRECT NUMBER: (317) 236-2110
DIRECT FAX: (317) 592-4713
INTERNET: TERRY.MUMFORD@ICEMILLER.COM

WRITER'S DIRECT NUMBER: (317) 236-2468
DIRECT FAX: (317) 592-4702
INTERNET: KATRINA.CLINGERMAN@ICEMILLER.COM

VIA EMAIL AND U.S. MAIL

Ms. Joyce Kahn
Manager, EP Voluntary Compliance
Mr. Joseph Grant
Director of Employee Plans
Mr. James E. Holland
Manager, EP Technical
Ms. Maxine B. Terry
Program Coordinator
Mr. Andrew Zuckerman
Director of Rulings and Agreements
Internal Revenue Service
SE:T:EP:RA:VC, PE-4L2
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Paul C. Hogan
Internal Revenue Agent/EP Specialist - ID# 91-07322
Internal Revenue Service
TE/GE:EP: VC 7554
915 Second Avenue, Mailstop 510
Seattle, WA 98174-1001

Re: VCP Submission #911659038 for the San Diego City Employees' Retirement System

Dear Ladies and Gentlemen:

The purpose of this letter is to reflect the remaining items from our July 10, 2007 meeting.

415 Testing

Enclosed you will find a new print reflecting the revised 415 retroactive testing. This chart shows that 102 participants have at some point in their retirement exceeded the 415 limit.

For that group, the chart shows each year post-retirement and the amount the benefits exceeded the limit that year (if at all). Those amounts have been run out through 6/30/07. Subsequent years' excess benefits (from July 1, 2007) will be billed to the City on the timetable required in the Preservation of Benefits Plan.

We have also enclosed a new Exhibit A showing the revised retrospective testing methodology. You will notice this assumes the IRS accepts the DROP ordering concept (DROP benefits paid count first toward 415(b) limit, monthly annuity benefits paid count second toward 415(b) limit) and the use of SDCERS's assumption of 8% to adjust the benefit forms. We have also enclosed a new Exhibit 2, revised to reflect the Final Regulations and other comments provided during our meeting on July 10th.

The total excess benefits, with interest to 6/30/07, total $8,160,027.

Presidential Leave

In our August 6, 2007 submission, we noted that we needed to confirm Mr. Farrar's benefit if union salary is not used. That amount is $3,858.38, for a total of $1,839.23 per month loss.

As to the Collins and Farrar employee contributions, Mr. Collins has confirmed that his contributions were deducted on a pre-tax basis. We have been unable to reach Mr. Farrar to obtain similar confirmation, although SDCERS will assume, for purposes of its reporting obligations, that the answer is the same, as both served with the same union.

Cashless Leave Conversion

We recognize that the IRS does not accept our initial proposed resolution on this issue, i.e. billing the City of the cost of the service granted. Consequently, with respect to the cashless leave conversion issue, we would like to propose that rather than billing the City for the cost of the leave granted under this program, SDCERS will provide the affected individuals with the opportunity to either pay for the service credit obtained through the conversion or forfeit that service credit. Members who choose to pay for the service granted would be treated, pursuant to SDCERS normal administrative procedure, in the same manner as members who have underpaid for a service purchase due to an administrative error. That is, those members would be permitted to pay an amount calculated as of the time of the original purchase. The affected members could choose the manner in which they wish to finance the payment (i.e., a rollover, a transfer, or after-tax installment payments). Obviously, the one affected member who has already retired would be unable to pay in a manner which would result in annual additions under Code Section 415(c), but would be offered the opportunity to rollover or transfer to make the purchase.

The affected members would then be free to reach an independent agreement with the City regarding the value of the leave surrendered in exchange for SDCERS service credit. We believe this approach would result in the elimination of the cashless leave conversion, both

retroactively in practice and prospectively due to the amendments contained in the Technical Compliance Ordinance, but without causing undue injury to the affected members.

Settlement Amounts

We have enclosed a schedule showing the Settlement Amounts as well as the amounts above the ARC the City has been paying since the VCP filings started.

Draft VCP Compliance Statement

We have enclosed a draft of an insert to the compliance statement for your consideration.

Comments on Technical Compliance Ordinance

We are waiting for comments from Mr. Hogan on the Technical Compliance Ordinance, which is critical because it resolves all of the plan design failures raised in SDCERS' filings. We look forward to receiving those.

We hope this is helpful to you in considering this final resolution to our submissions.

Very truly yours,

ICE MILLER LLP

Mary Beth Braitman

Terry A.M. Mumford

Katrina M. Clingerman

MBB/KMC:mlf/kwc
cc: David Wescoe
Roxanne Story Parks
Bob Wilson
Chris Waddell
David Arce
Ken Kent
Gene Kalwarski

SDCERS CONTRIBUTION SCHEDULE AND SETTLEMENT AMOUNTS

ARC is for Fiscal Year	Valuation Report Date	Prepared By	ARC Amount	Payment Dates	Amount Paid to Date	Amounts Due from City per IRS (Amounts Due Established Per IRS Settlement)	Amount Paid Over the ARC Since 7/12/05
7/1/2005 to 6/30/2006	6/30/2004	GRS	$156.0 M	7/1/2005	$163.0 M	(Note: Initial IRS filing made 7/12/05. Additional filings proposing additional City contributions made 4/19/06, 5/9/06, 6/7/06, 6/13/06, 6/19/06, and 6/22/06.)*	
Extra City Contribution Received		(Note: Cheiron replicated numbers)		6/22/2006	$100.0 M		
Extra City Contribution Received				6/29/2006	$8,298,430	401(h) for First Period: $31,618,356 Retiree Health Administrative Expenses: $2,211,895 10% Disability Overpayment: $1,221,543	$108,298,430**
7/1/2006 to 6/30/2007	6/30/2005	Cheiron	$162.0 M	7/1/2006	$162.0 M	(Note: IRS filing on 415 made 8/6/06) ***	
Extra City Contribution Received				6/29/07	$6.2 M	415 Excess Benefits: $8,160,027	$7,008,977
Extra City Contribution Received				6/30/07	$808,977		
7/1/2007 to 6/30/2008	6/30/2006	Cheiron	$137.7 M	7/2/2007	$137.7 M		
Extra City Contribution Received				7/2/2007	$27,334,773		$27,334,773
GRAND TOTALS			**$455,700,000**		**$605,342,180**	**$43,211,821**	**$142,642,180**

* Settlement amounts in this group calculated as of June 30, 2006. Includes interest at 8% to June 30, 2006.
** Did not include difference between $163 and $156 M since paid 7/1/05 prior to first filing with IRS on 7/12/05.
*** Settlement amounts calculated as of June 30, 2007. Includes interest at 8% to June 30, 2007.

August 20, 2007

I/1994231.1

Exhibit 13

REQUEST FOR COUNCIL ACTION

CITY OF SAN DIEGO

1. CERTIFICATE NUMBER:

TO:	2. FROM: (ORIGINATING DEPARTMENT)	3. DATE
CITY ATTORNEY	CITY EMPLOYEES' RETIREMENT SYSTEM	02/13/2001

4. SUBJECT

Amendments to S.D. Muni. Code, Chap. II, Art. 4, by adding Div. 16 entitled "Preservation of Benefit Plan"

5. FOR INFORMATION, CONTACT: (NAME & MAIL STA.)	6. TELEPHONE NO.	7. CHECK HERE IF BOX 1472A, "DOCKET SUPPORTING INFORMATION," HAS BEEN COMPLETED ON PAGE 2:
Loraine E. Chapin, General Counsel, MS #840	619-533-4699	☑

8. **COMPLETE FOR ACCOUNTING**

FUND				
DEPT.				
ORGANIZATION				
OBJECT ACCOUNT				
JOB ORDER				
C.I.P. NO.				
AMOUNT				

9. ADDITIONAL INFORMATION / ESTIMATED COST:

FISCAL IMPACT: NONE

10. **ROUTING AND APPROVALS**

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	DEPARTMENT DIRECTOR	Lawrence B. Grissom Lawrence B. Grissom	2/2/01

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
2	CITY MANAGER	Cathy Lexin	2/5/01
3	AUDITOR	[signature]	2-13-1
4	CITY ATTORNEY	Renee C McAtee	2/15/01
5	ORIGINATING DEPARTMENT	Lawrence B. Grissom	2/2/01

√ MGR. DOCKET COORD. _____ COUNCIL REP.

RULES COMMITTEE ☐ CONSENT ☒ ADOPTION

BB ☐ Refer to _____ Date MAR 05 2001

11. PREPARATION OF: ☐ RESOLUTION(S) ☑ ORDINANCE(S) ☐ AGREEMENT(S) ☐ DEED(S)

The Board of Administration ("Retirement Board") for the San Diego City Employees' Retirement System recommends amendments to San Diego Municipal Code, Chapter II, Article 4.

11a. MANAGER'S RECOMMENDATIONS:

O- 18930 MAR 19 2001

12. SPECIAL CONDITIONS (REFER TO A.R. 3.20 FOR INFORMATION ON COMPLETING THIS SECTION.)

CITY CLERK INSTRUCTIONS: Please forward a copy of the Ordinance to SDCERS, Loraine Chapin, MS #840.

DOCKET SUPPORTING INFORMATION

CITY OF SAN DIEGO

DATE: 02/13/2001

SUBJECT:

Amendments to S.D. Municipal Code, Chap. II, Art. 4, by adding Division 16 entitled "Preservation of Benefit Plan."

BACKGROUND:

San Diego City Employees' Retirement System ("Retirement System") is a tax qualified retirement plan that must meet the requirements of Section 415 of the Internal Revenue Code ("Code"). In certain cases, Section 415 of the Code prevents the Retirement System from paying fully earned benefits to Members of the Retirement System. The Small Business Job Protection Act of 1966 permits the City of San Diego to adopt a "qualified governmental excess benefit arrangement" solely for the purpose of providing Members of the Retirement System the full amount of benefits that would otherwise be paid by the Retirement System but for the limits of Section 415. The Retirement Board requests the Council of the City of San Diego to adopt a separate plan that meets the provisions of the Code and thereby preserve benefits which cannot be paid from the Retirement System due to the limitations of Section 415 of the Code. The separate plan to be adopted for this purpose shall be known as the Preservation of Benefit Plan. It is now necessary and proper to amend the San Diego Municipal Code to adopt and set forth the terms, conditions and benefits for the Preservation of Benefit Plan. The Retirement Board has reviewed and approved the Preservation of Benefit Plan and recommends its adoption. A vote of the Retirement System's membership is not required by Charter section 143.1.

FISCAL IMPACT: None.

O-18930

BY LINE: (CITY MANAGER / DEPT. HEAD / AUTHOR INITIALS)

SIGNATURES:

Lawrence B. Grissom

ORIGINATING DEPT. HEAD

LAWRENCE B. GRISSOM

Cathy Lexin

CITY MANAGER

(FOR MANAGERIAL DEPARTMENTS ONLY)

CERTIFICATE OF PUBLICATION

Purchase Order #018912
City of San Diego
Karen Crenshaw/City Clerk's Office
202 C Street, M.S. 2A
San Diego, CA 92101

IN THE MATTER OF

0-18930

ORDINANCE NUMBER O-18930 (NEW SERIES)

AN ORDINANCE AMENDING CHAPTER II, ARTICLE 4, DIVISIONS 1 AND 10, OF THE SAN DIEGO MUNICIPAL CODE BY AMENDING SECTIONS 24.0103 AND 24.1010; BY ADDING SION 16 TITLED "PRESERVATION OF BENEFIT PLAN" BY ADDING IONS24.1601, 24.1602, 24.1603, 24.1604, 24.1605, 24.1606, 24.1607 AND 24.1608, ALL RELATING TO THE SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM.

nance amends the San Diego City Employees Retirement System to add te qualified governmental excess benefits arrangement, a plan authorized ernal Revenue Code [Code] to accommodate retirement benefits for those es whose actual earned retirement benefits exceed the limit on such stablished by section 415 of the Code. This will ensure that City employees' are not artificially reduced by the section 415 limit.

nance contains a notice that a full reading of this ordinance is dispensed to its final passage, since a written or printed copy will be available to the ncil and the public a day prior to its final passage.

nance shall take effect and be in force on the thirtieth day from and after ge.

te copy of the Ordinance is available for inspection in the Office of the City the City of San Diego, 2nd Floor, City Administration Building, 202 C an Diego, CA 92101.

ed on February 27, 2001.

and adopted by the Council of the City of San Diego on March 19, 2001.

AUTHENTICATED BY:
DICK MURPHY
Mayor of The City of San Diego, California
CHARLES G. ABDELNOUR
City Clerk of The City of San Diego, California
By: Peggy Rogers, Deputy

6-e123385

I, Lou Sto. Domingo , am a citizen of the United States and a resident of the county aforesaid; am over the age of eighteen years, and not a party to or interested in the above-entitled matter. I am the principal clerk of the San Diego Public Record Reporter, a newspaper of general circulation, printed and published daily, except Saturdays and Sundays, the City of San Diego, County of San Diego and which newspaper has been adjudged a newspaper of general circulation by the Superior Court of the County of San Diego, State of California, under the date of June 18, 1997, Decree No. 00710548; and the

ORDINANCE

is a true and correct copy of which the annexed is a printed copy and was published in said newspaper on the following date(s), to wit:

APRIL 6

I certify under penalty of perjury that the foregoing is true and correct.

Dated at San Diego, California this 6th day of

APRIL, 2001

(Signature)

(O-2001-126)
(COR. COPY)

ORDINANCE NUMBER O-18930 (NEW SERIES)

ADOPTED ON MAR 19 2001

AN ORDINANCE AMENDING CHAPTER II, ARTICLE 4, DIVISIONS 1 AND 10, OF THE SAN DIEGO MUNICIPAL CODE BY AMENDING SECTIONS 24.0103 AND 24.1010; BY ADDING DIVISION 16 TITLED "PRESERVATION OF BENEFIT PLAN" BY ADDING SECTIONS 24.1601, 24.1602, 24.1603, 24.1604, 24.1605, 24.1606, 24.1607 AND 24.1608, ALL RELATING TO THE SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM.

WHEREAS, the San Diego City Employees' Retirement System ("Retirement system") is a tax qualified retirement plan that must meet the requirements of Section 415 of the Internal Revenue Code ("Code"); and

WHEREAS, in certain cases, Section 415 of the Code prevents the Retirement System from paying fully earned benefits to Retirement System members; and

WHEREAS, the Small Business Job Protection Act of 1996 permits the City of San Diego to adopt a "qualified governmental excess benefit arrangement" solely for the purpose of providing Retirement System members the full amount of benefits that would otherwise be paid by the Retirement System but for the limits of Section 415; and

WHEREAS, the Board of Administration for the Retirement System ("Board") has requested the Council of the City of San Diego to adopt a separate plan that meets the provisions of the Code and thereby preserve benefits which cannot be paid from the Retirement System due to the limitations of Section 415 of the Code; and

WHEREAS, the Board directed its General Counsel to draft a separate plan for this purpose; and

WHEREAS, the Preservation of Benefits Plan drafted by the Board's General Counsel has been reviewed by the Board's Tax consultant, the Auditor and the City Attorney; and

WHEREAS, it is now necessary and proper to amend the San Diego Municipal Code to add Division 16, Sections 24.1601 - 24.1608 to adopt and set forth the terms, conditions and benefits for the Preservation of Benefit Plan as well as amend other sections in other divisions to add a definition for the Internal Revenue Code and to provide further for a fiscal limitation year for Internal Revenue Code Section 415 testing purposes; and

WHEREAS, the Board has reviewed and approved the ordinance setting forth the Preservation of Benefit Plan and related amendments and recommends its approval by the City Council; and

WHEREAS, a vote of the Retirement System's membership is not required by Charter section 143.1, NOW, THEREFORE,

BE IT ORDAINED, by the Council of The City of San Diego, as follows:

Section 1. That Chapter II, Article 4, Division 1, of the San Diego Municipal Code be and the same is hereby amended by adding the following definition, in the correct alphabetical order, to Section 24.0103 to read as follows:

SEC. 24.0103 Definitions

Unless otherwise stated, for purposes of this Article:

[No change in text of other definitions].

"Code" unless otherwise indicated means the Internal Revenue Code of 1986, as amended.

Section 2. That Chapter II, Article 4, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.1010 to read as follows:

SEC. 24.1010 Compliance with Certain Internal Revenue Code Provisions

(a) No Change.

(b)(1)-(5) No Change.

(b)(6) All references to Section 415 of the Internal Revenue Code are to the language in Section 415 in effect when this Municipal Code is adopted including any amendments thereafter. For purposes of Section 415 testing, the limitation year shall be based on a fiscal year beginning on July 1 and ending on June 30.

(b)(7) No Change in text.

Section 3. That Chapter II, Article 4, of the San Diego Municipal Code be and the same is hereby amended by adding Division 16, Titled "Preservation of Benefit Plan" and by adding Sections 24.1601, 24.1602, 24.1603, 24.1604, 24.1605, 24.1606, 24.1607 and 24.1608, to read as follows:

DIVISION 16

PRESERVATION OF BENEFIT PLAN

SEC. 24.1601 Creation

(a) A "Preservation of Benefit Plan" ("Plan"), separate and apart from any other plan administered by the Retirement Board, is established and adopted to preserve the benefits otherwise earned by Members of the Retirement System to the extent their benefits are reduced by the limitations on benefits imposed by Section 415 of the Internal Revenue Code ("Code").

(b) This Plan is intended to be a "qualified governmental excess benefit arrangement" within the meaning of Section 415(m) of the Code. It shall be deemed a

portion of the Retirement System solely to the extent required under, and within the meaning of, Section 415(m)(3) of the Code and Article IX of the San Diego City Charter.

(c) In accordance with section 415(m) of the Code, this Plan is established solely for the purpose of providing to participants and their beneficiaries that part of their annual benefit otherwise payable under the Retirement System that exceeds the limitations on benefits imposed by section 415 of the Code.

(d) This Plan is an "exempt governmental deferred compensation plan" described in section 3121(v)(3) of the Code. Sections 83, 402(b), 457(a) and 457(f)(1) of the Code shall not apply to this Plan. With respect to Code section 457(a), the maximum amount that may be deferred under this Plan on behalf of any Participant for the taxable year may exceed both the amount in Code section 457(b)(2) (as adjusted for cost of living increases) and the percent of the participant's includable compensation in that Code section. The System will not hold any assets or income under this Plan in trust for the exclusive benefit of participants or their beneficiaries.

SEC. 24.1602 Eligibility

(a) Participation in this Plan is limited to those Members of the Retirement System whose benefits at the time of payment are reduced by Section 415 of the Code.

(b) Participation shall commence as of the first date on which benefits limited by section 415 of the Code are payable to the Member from the Retirement System.

(c) Participation in this Plan shall cease on the first date on which benefits payable from the Retirement System to the Member are no longer reduced by Section 415 of the Code.

(d) A Member's beneficiary shall receive benefits under this Plan on the first date on which the benefits payable to the beneficiary from the Retirement System are limited by section 415 of the Code. The benefits received under this Plan by a Member's Beneficiary shall cease on the first date on which the benefit is no longer reduced by Section 415 of the Code.

(e) No other Member or beneficiary of the Retirement System shall have any right to benefits under this Plan.

SEC. 24.1603 Benefit

(a) The benefit under this Plan shall be the difference between the benefit that would be payable to the Member under the Retirement System, if it were not reduced by Section 415 of the Code, and the benefit actually payable to the Member, as reduced by Section 415 of the Code.

(b) Appropriate adjustments in accordance with Section 415 of the Code and the regulations thereunder shall be made in determining the benefit both reduced and unreduced in regard to Section 415 of the Code, including but not limited to taking into account the form of the benefit payable.

(c) Any amount payable to a Member or beneficiary pursuant to this Plan shall be paid in the same form of benefit, at the same times and for the same period as benefits are paid to the Member or beneficiary under the Retirement System.

(d) The benefits for Deferred Option Retirement Plan ("DROP") participants are not impacted by the limits of Section 415 of the Code until the member terminates employment at the end of the member's DROP participation period. To the extent possible, and with respect to DROP benefits from set forth in Division 14 of the

San Diego Municipal Code, the Board shall arrange for any DROP benefits to be paid from the Retirement System and not from this Plan.

(e) The City and Unified Port District shall make appropriate arrangements to deduct from all amounts paid under this Plan any taxes required to be withheld with respect to this Plan by any government or governmental agency. To the extent any payroll taxes (including FICA taxes) are due on benefits paid under this Plan, the City and Unified Port District shall:

(1) pay such taxes due, if any, from the employer;

(2) collect such taxes due, if any, from the participant or beneficiary by withholding the taxes from payments otherwise due under this Plan; and

(3) take all reasonable steps to reduce such taxes.

SEC. 24.1604 Exemption from Process; Assignments Prohibited

(a) The benefit under this Plan shall not be subject to execution, garnishment, attachment or any other process of any court with respect to a participant or beneficiary under this Plan except to the extent permitted by California Code of Civil Procedure Section 704.110.

(b) The benefit under this Plan shall not be subject to any anticipation, alienation, sale, assignment, pledge, encumbrance or charge by any person. Any attempt to anticipate, alienate, sell, assign, pledge, encumber or charge the benefit shall be void.

(c) The benefit under this Plan is not transferable by *inter vivos* gift or testamentary disposition.

SEC. 24.1605 Administration

(a) Administration of the Plan shall be under the exclusive management and control of the Board. In administering this Plan, the rights, duties and responsibilities of the Board shall be the same as for other plans administered by the Board under other divisions of the San Diego Municipal Code.

(b) With respect to the administration of this Plan, the Board shall act separately and apart from its duties with respect to any other plan administered by the Board. No costs or expenses of administering this Plan shall be paid directly or indirectly by the Retirement System. The costs of administering this Plan shall be the responsibility of the City and the Unified Port District, in proportion to the benefits being paid under this Plan to their former employees.

(c) The Board shall determine all issues relating to the rights of participants, beneficiaries and their legal representatives under the terms of the Plan, including eligibility, the amount and time of payment of the benefit (if any) and the calculation of the benefit under this Plan.

(d) The Board shall compile and maintain all records necessary or appropriate for the administration of this Plan, including but not limited to the making of requisite calculations under this Plan.

(e) The Board shall obtain such information from the City or Unified Port District with respect to Members of the Retirement System as shall be necessary and appropriate to determine the rights and benefits of participants and beneficiaries under this Plan.

(f) The Board shall furnish to the City and the Unified Port District, upon request, reports concerning the administration of this Plan.

(g) The Board shall determine any factual questions arising in connection with this Plan's operation or administration after such investigation or hearing as the Board deems necessary and appropriate.

SEC. 24.1606 Source of Benefits Funding and Contributions

(a) The Plan shall be unfunded within the meaning of the federal tax laws.

(b) No employee contributions or deferrals shall be made or allowed under the Plan.

(c) Benefits due under this Plan as determined by the Board, on the advice of its actuary, shall be paid for by the City and Unified Port District.

(d) City and Unified Port District contributions to the Retirement System for any fiscal year shall be reduced by an amount determined by the Board, on advice of its actuary, as necessary to meet the requirement for benefits under this Plan.

(e) The City and Unified Port District assets used to provide benefits under this Plan may not be commingled with the monies of any other Plan in the Retirement System or any other qualified plans, nor may this Plan ever receive any transfer of assets from the Trust Fund established for any other plan in the Retirement System.

(f) The City or Unified Port District shall retain title to the beneficial ownership of any assets, including cash or other investments, which the City or Unified Port District may earmark to pay any amount under the Plan. No one entitled to benefits under this Plan shall have any property interest whatsoever in any specific assets of the City or Unified Port District.

(g) The obligation of the City and Unified Port District to make payments pursuant to the Plan is contractual only. No one entitled to benefits hereunder shall have a preferred claim or lien on any assets of the City or Unified Port District.

SEC. 24.1607 Process for Determination of Plan Benefits and Contributions

(a) By February 1 of each year the Retirement Administrator shall identify those retirees and beneficiaries whose benefit exceeds the limits of Section 415 of the Code.

(b) The Retirement Administrator shall determine the amount of the benefit to be paid to these retirees or beneficiaries under this Plan in accordance with Section 24.1603.

(c) The Retirement Administrator shall notify the City and Unified Port District of those retirees and beneficiaries whose benefit exceeds the limits of Section 415 of the Code as well as the amounts due those retirees and beneficiaries under this Plan.

(d) The City and Unified Port District, respectively, shall fund an amount equivalent to the benefits that exceed the limits of Section 415 of the Code.

(e) The City and Unified Port District contributions to the Retirement System shall be reduced by an amount equal to the benefits identified by the Retirement Administrator which exceed the limits of Section 415 of the Code based upon the Board's approval of the contribution rates recommended by its actuary.

SEC. 24.1608 Amendment or Termination of Plan

(a) The Board shall have the right to amend this Plan at any time to preserve the tax qualified status of the Retirement System or comply with federal or state laws.

(b) The City shall have the right to amend the Plan to the extent it deems advisable or to terminate the Plan. No amendment or termination shall deprive any participant or beneficiary under this Plan of any benefits to which he or she is entitled to under the Plan as of the date of amendment or termination.

Section 4. The City Auditor and Comptroller is hereby authorized to create a Special Fund to receive and disburse funds in accordance with this ordinance. Any funds deemed to be excess will be transferred back to the contributing funds.

Section 5. A full reading of this ordinance is dispensed with prior to its final passage, a written or printed copy having been available to the City Council and the public a day prior to its final passage.

Section 6. This ordinance shall take effect and be in force on the thirtieth day from and after its passage.

APPROVED: CASEY GWINN, City Attorney

By Theresa C McAteer
Theresa C. McAteer
Deputy City Attorney

TCM:LEC:lb
02/15/01
03/15/01 (COR. COPY)
Or. Dept:Retirement
Aud.Cert.:
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